INDIVIDUAL AND CORPORATION MORTGAGES

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INVESTMENT BANKERS ASSOCIATION
OF AMERICA

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Individual and Corporation Mortgages

A Statement for Laymen of the Legal Principles

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PREFACE

Formerly it was the general belief, and it still is a common idea, that business must be regarded in the nature of a trade, of which a knowledge can be acquired only through the accumulation of personal experience, or through transmission from the older to the younger man.

There is now a constantly enlarging number of people who believe that business can be and should be made more and more to approximate the nature of a profession, and that at least some of the accumulated experience can be set forth in writing for the benefit of the younger men who are engaging or expecting to engage in business pursuits. Such written statements about business at first must be fragmentary, and they are likely to be dogmatic. It is perhaps not unreasonable to hope that they will become more and more scientific, more and more in the nature of principles deduced from the multifarious facts.

It is in the hope of enlarging by its contributing mite the body of useful written matter on the subject of business that this brief statement of the legal incidents of a mortgage has been written. The legal aspect of business

transactions is of course a part of the total nature of, and completely pervades, the transactions themselves. The fact that the law has long undergone its scientific development makes it one of the most penetrating instruments for the study of business. This accounts partly for the fact that lawyers have often made markedly competent business men.

It is a maxim that "ignorance of the law excuses no one." Certainly the more general and sound the understanding of legal matters in a community the better for the welfare of the community. A business man certainly must acquire a considerable acquaintance with the law in his accumulation of business experience. In fact he comes to regard certain fundamental things as elementary; he presumes that every one knows them. He assumes, for example, that every one knows the general nature of a mortgage.

Increasing complexity of business resulting in greater specialization probably makes a general knowledge of the law much less common now than formerly. Many young men entering business are very hazy about the precise nature of such a thing as a mortgage. Certainly the young man choosing finance as the particular occupation he intends to follow should not be foggy in his ideas about this particular legal instrument. The nature of the investment contract is of the very essence of the security of a corporate obligation. No one can hope really to understand the corporate mortgage bond who

has only the vaguest idea of the nature of a mortgage. The most elaborate of corporation mortgages has for its basis the same fundamental principles which underlie the simplest mortgage of an individual on the humblest house and lot. Any study of corporation finance or investments should have near its very beginning a study of the legal aspects of a mortgage sufficient to afford an understanding of its nature and pervading principles. The legal treatises, however, are too voluminous and too technical for the layman. Those brief statements of the law which previously have been written for laymen are not sufficiently comprehensive for the student of corporation finance and investments.

It would be impossible to discuss all the principles of law which have a bearing on mortgages within the scope of a short volume. It is hoped, however, that a sufficient number of the principles of law and equity governing mortgages will be found in the following pages to fill at least in part the needs of the layman in gaining an understanding of the mortgage as a legal instrument.

Mr. William M. Wherry of the New York bar read the manuscript and made valuable suggestions. Mr. Hastings Lyon, my partner in the practice of the law, has been of constant assistance in the preparation of this little book.

WILLIAM LILLY.

New York City,
July 24, 1918.

INDIVIDUAL AND CORPORATION MORTGAGES

PART I

THE INDIVIDUAL MORTGAGE

"Vif-gage" and "Mort-gage"

There were two methods known to the Anglo-Saxons for the return of real property pledged by a debtor to secure the repayment of a loan.

According to one method the creditor took title to the property and also all the rents and profits until he recouped himself for the loan. This was called a live pledge—"vif-gage."

By the other method the creditor took title to the debtor's property with the agreement that the debtor should repay the loan on a day certain, and if the loan was not repaid on the day so fixed by the parties, which was called the "law-day," the creditor became the owner of the property absolutely and forever. This was called a dead pledge—"mort-gage."

A Common Law Mortgage

What is a common law mortgage?

Jones, the absolute owner of a parcel of land worth $15,000, conveys all his right, title and

interest in it, by deed under seal, to Brown, as security for the repayment three years thereafter of the sum of $10,000 which Brown thereupon loans to him.

The deed contains a provision that if Jones repays the loan on the day when it becomes due, the deed shall become void; otherwise it is in full force and effect.

Accordingly, Jones is under no liability to repay the loan when it becomes due. If he does, he gets back his land; if he does not, Brown becomes the absolute owner, taking the land in lieu of repayment of the loan.

A simple transaction. Yet it contains all the elements of, and is in fact, a common law mortgage of realty.

That Jones might have conveyed the land to Brown, not as security for the repayment of a loan, but as security for the performance of some other act for which Brown has given him something of value, does not alter the essential nature of the transaction.

Hence, "at common law a mortgage of realty may be defined as an estate created by a conveyance, absolute in its form, but intended to secure the performance of some act, such as the payment of money or the like, by the grantor or some other person, and to become void if the act is performed agreeably to the terms prescribed at the time of making such conveyance."[1]

[1] ("Cyclopedia of Law and Procedure," Vol. 27, p. 957.)

Common Law Doctrine

The law of mortgages does not, however, end with the respective rights of the parties thus created.

By the strict doctrine of the common law, Brown, upon having parted with something of value to Jones and received the deed, became entitled forthwith to possession, being considered the absolute owner of the land, and could maintain a suit to eject Jones from it; although if Jones punctually performed the condition of the mortgage, that is, made payment of the debt, or performed whatever other act he was to do, on the day appointed in the mortgage—the "law day"—Brown's ownership thereupon ceased and determined. But, as the deed had conveyed the legal title, it was necessary for Brown to reconvey it by deed under seal, in order to restore Jones to the absolute ownership of the property at law.

If Jones failed, however, to perform punctually on the law day, he forfeited all his right and interest in the property.

Equitable Doctrine—Equity of Redemption

This harsh doctrine of the common law whereby Jones would absolutely forfeit his estate upon failure to perform his obligation fully and punctually on the law day, met with disfavor at an early date in the English courts of equity. They were not bound by the same rules as the courts of law, but were clothed with power to deal out

justice between parties when the law might otherwise work an injustice. Accordingly, the rule was established that in equity the debtor should still have a right to redeem his estate by fulfilling his obligation after the law day. Equity considered the debt as the principal thing and the mortgage merely as accessory thereto. This right of the debtor to save his estate in equity after forfeiture at law was called "the equity of redemption," and the same term came to be applied to the interest or estate retained by Jones after he had executed the mortgage—in terms of currency $5,000 in the case just cited.

Thus equity intervened and abrogated to a certain extent the principles of the common law.

Present Status of the Law

The doctrine of the common law still prevails in some of the states of this country, but in most states it has been modified by the equitable principle just stated, either at the hands of the courts, or by statute, and in these states a mortgage is considered a mere lien or security for a debt, passing no title or estate to the mortgagee, and giving him no right or claim to possession of the property.

In Texas all mortgages and deeds of trust upon lands or chattels are but securities. The legal estate and the right of possession remain in the mortgagor.

In Louisiana by reason of the Spanish and French occupation the Civil law derived from

the old Roman law still prevails. There the legal title and possession passes to the creditor, but subject to the borrower's right to repay the loan and redeem his property, and on failure to repay the loan on the day fixed by the parties, the property must be sold at judicial sale and the surplus, if any, paid to the borrower.

Mortgage a Contract Agreement

A mortgage is a contract agreement, and can never arise except by agreement between the parties. Jones and Brown, as free contracting parties, may by agreement insert almost any provision in the mortgage permitted by law. Indeed, even statutory provisions unless expressly mandatory, may be waived by express agreement of the parties.

Sale or Transfer of Respective Interests

Furthermore either Jones or Brown may at any time sell, assign, or transfer his interest in the property.

Construing a Mortgage—Requisites

To ascertain the rights and liabilities created by a mortgage today, it is therefore necessary to examine the mortgage agreement not only in the light of the common law, but also with a view to such modifications as may be met with at the hands of equity courts and the state statutes.

Such is the field of mortgages — almost boundless.

Yet there are certain principles of the common law relating to mortgages still of almost universal application, and where modified, the courts have commonly applied certain well-recognized principles of equity, that have commonly found their way, expressed in one form or another, into such statutes as may obtain.

A statement of these general principles will afford a fairly clear conception of the law of mortgages, if the fact is constantly kept in mind that exceptions may be found either in the decisions of the courts or the statutes of any particular state.

Equity, however, so dominates the law of mortgages that in view of the familiar maxim "equity follows the law," it is important to understand something of the dual nature of English jurisprudence, from which American jurisprudence is for the most part derived.

What is Equity?

"Equity is that system of justice which was administered by the High Court of Chancery in England in the exercise of its extraordinary jurisdiction. * * * Equity, in its technical and scientific legal sense, means neither natural justice nor even all that portion of natural justice which is susceptible of being judicially enforced. It has, when employed in the language of the English law, a precise, definite, and limited sig-

nification, and is used to denote a system of justice which was administered in a particular court."[1]

After the Norman conquest the supreme judicial authority rested in the King, assisted by his councils, the great council, afterward called the Parliament, and the smaller council, which advised the King between the sessions of the great council.

The common law courts were governed by hard and fast rules. There was no writ by which a defective instrument could be reformed, a mistake or accident rectified, a fraudulent conveyance set aside, or the beneficial interest in property enforced against the holder of the legal title. Moreover, a judgment was unequivocally either for the plaintiff or for the defendant. This gave rise to the practice of a party litigant making application to the Chancellor, who was the secretary of the King and also probably secretary of the small council, to have his cause heard by the small council whose decree could be so molded as to work out complete justice between the parties.

From this practice of making application to the Chancellor and obtaining a decree from the small council, evolved the High Court of Chancery, and its counterparts, the courts of equity in this country.[2] By the "Supreme Court Judi-

[1] (Bispham's "Principles of Equity," Ninth Edition, pp. 1 and 2.)

[2] (*Id.*, Chapter 1.)

cature Act of 1873" the distinction between courts of law and courts of equity was abolished in England.[1] Similar enactments have accomplished the same results in a majority of the states of this country, so that both law and equity are administered by the same court.

It is, nevertheless, still important to distinguish the principles of the common law from those of equity origin. The principles guiding the court in the exercise of its equity jurisdiction are for the most part succinctly expressed in maxims which will be considered in due course.

The Mortgage Agreement

The mortgage agreement must be distinguished from the term "an agreement to mortgage." The former is the mortgage instrument itself; the latter is a contract between the parties, which may be very informal, wherein one party agrees to execute some time in the future a mortgage in favor of the other.

It is impossible to describe a simple mortgage of realty universally ideal owing to the variation in the laws and prescribed forms of mortgages of the several states.

However, the following examples may suffice as a basis for consideration of such essential and such desirable, though non-essential, elements of a mortgage as would fulfill the requirements in a majority of the states.

[1] (Bispham's "Principles of Equity," Ninth Edition, p. 2.)

EXAMPLE 1

	Know all men by these presents, that
(Name of Mortgagor)	I, [John Jones,] for and in consideration
(Am't of consideration)	of the sum of [$10,000] to me in hand before the delivery hereof well and truly
(Name of Mortgagee)	paid by [James Brown,] the receipt whereof I do hereby acknowledge, [have
(Words of grant commonly called "Granting Clause")	granted, bargained and sold, and by these presents do give, grant, bargain, sell, alien, enfeoff, convey, and confirm unto] the said James Brown, his heirs and assigns forever,
	(Here insert description of Property)
(Habendum Clause)	[To have and to hold the said granted premises, with all the privileges and appurtenances to the same belonging to him, the said James Brown, and his heirs and assigns, to his and their own proper use and benefit forever.]
	(Covenants of Mortgagor may be inserted here)
(Name of Mortgagor's wife)	And I, [Mary Jones,] wife of the said John Jones, in consideration aforesaid,
(Wife joins in mortgage deed, relinquishing common law right of dower)	[do hereby relinquish my right of dower in the before mentioned premises.]
(Defeasance clause making deed operate as a mortgage)	[Nevertheless, it is to be considered and the condition of the foregoing deed is such, that if the said John Jones, his heirs, executors and administrators, shall well and truly pay unto the said James
(Am't of consideration)	Brown, his heirs and assigns, [$10,000] then the foregoing deed is to be void, and of no effect;] otherwise to remain in full force and virtue.
(Testimonium clause)	[In witness whereof, we have hereunto
(Date)	set our hands and seals this [15th day of June in the year of our Lord, 1917.]]
(Signature of Mortgagor)	[John Jones] (Seal)
(Signature of Mortgagor's wife)	[Mary Jones] (Seal)
(Attestation clause)	[Signed, sealed and delivered in the presence of:]
(Signature of attesting witness or witnesses)	[Henry Bullock.]

A Form of Acknowledgment for Husband and Wife

State of New Jersey, }
County of Essex, } ss:

On this 15th day of June in the year 1917, personally appeared before me, Timothy Smith, a commissioner of deeds in and for the state of New Jersey, John Jones and Mary Jones, his wife, who, I am satisfied, are the grantors mentioned in the above deed of conveyance; and I having first made known to them the contents thereof, they did severally duly acknowledge that they signed, sealed and delivered the same as their voluntary act and deed; and the said Mary Jones, being of full age, on private examination apart from her husband, before me acknowledged that she signed, sealed and delivered the same as her voluntary act and deed, freely, without any fear, dread or compulsion of her said husband.

In Witness Whereof, I have hereunto set my hand and seal this 15th day of June, 1917.

(SEAL of Timothy Smith, Commissioner of Deeds, State of New Jersey.)	TIMOTHY SMITH, Commissioner of Deeds, County of Essex, State of New Jersey.

EXAMPLE 2

(Name of Instrument) (Date) (Name of Mortgagor) (Address of Mortgagor)	[THIS INDENTURE] made the [15th day of June in the year nineteen hundred and seventeen,] between [JOHN JONES] of [No. ...... Street, Borough of Manhattan, City, County and State of New York,] hereinafter described as party of
(Name of Mortgagee) (Address of Mortgagee)	the first part, and [JAMES BROWN] of [No. ...... Street, Borough of Manhattan, City, County and State of New York,] hereinafter described as party of the second part,

(Preamble) (Reference to bond or note accompanying the mortgage) (Am't of consideration)	[WHEREAS, the said JOHN JONES by virtue of a certain bond or obligation bearing even date herewith is justly indebted to the said party of the second part in the sum of [ten thousand dollars,] lawful money of the United States, secured to
(Here interest is added)	be paid, [together with the interest] thereon, at the time and in the manner expressed in said bond or obligation.
(Covenant of Mortgagor as to payment) (Events of default)	[IT BEING THEREBY EXPRESSLY AGREED, that the whole of the principal sum shall become due] [after default in the payment of interest, taxes, or assessments,] as hereinafter provided.
(Amount of consideration by reference to bond, or note, as case may be, accompanying the mortgage)	[NOW THIS INDENTURE WITNESSETH: that the party of the first part, for the better securing of the payment of the sum of money mentioned in the said bond or obligation, with the interest thereon, and also for and in consideration of one dollar paid by the party of the second part,] the receipt whereof is hereby acknowledged,
(Granting clause) (These words convey the estate in fee simple—an absolute grant of the entire estate)	does hereby [grant and release unto the party of the second part, and to his heirs, executors, administrators and assigns forever,] all
	(Description of property)
(This clause adds "fixtures and personal property attached to or used in connection with, the property covered by the mortgage")	[TOGETHER with all fixtures and articles of personal property attached to, or used in connection with said premises, all of which is declared to be covered by this mortgage.]
(This adds the appurtenances also to the grant)	[TOGETHER with all the appurtenances, and all the estate and rights of the party of the first part, in and to said premises.]
(Habendum clause)	[TO HAVE AND TO HOLD the above granted premises unto the party of the second part, his heirs, executors, administrators and assigns forever,]
(Defeasance	[PROVIDED ALWAYS, that if the party of the first part JOHN JONES or the heirs, executors or

	administrators of the party of the first part shall pay unto the party of the second part, his heirs, executors, administrators or assigns, the said sum of money mentioned in the said bond or obligation, and the interest thereon, at the time and in the manner mentioned in the said bond or obligation, that then these presents and the estate hereby granted, shall cease,
Clause)	determine and be void.]
	AND the party of the first part covenants with the party of the second part as follows:
	(Covenants of Mortgagor)
(Witness Clause)	[IN WITNESS WHEREOF, the said party of the first part has signed and sealed this instrument the day and year first above written.]
(Signature of mortgagor)	[JOHN JONES] (Seal of Mortgagor)
(Attestation clause)	[In the presence of:]
(Signature of witness or witnesses)	[HENRY BULLOCK.]

A Form of Acknowledgment for Individual

State of New York, }
County of New York, } ss:

On this 15th day of June, in the year 1917, before me personally came JOHN JONES, to me personally known and known to me to be the individual described in and who executed the foregoing instrument, and acknowledged that he executed the same for the uses and purposes therein mentioned.

(SEAL of Timothy Smith, Commissioner of Deeds, State of New York.)	TIMOTHY SMITH, Commissioner of Deeds, County of New York, State of New York, New York County Register's No. .....

Name of Instrument

Technically an indenture is an instrument executed by two or more parties containing provisions binding each one to the other. It was originally deemed essential that the instrument be written in two copies upon a different part of the same parchment which was then cut asunder in a waving or notched line. Hence the name "indenture." One copy was sealed by one party who delivered it to the other and received from the latter in turn the other part, with his seal thereon. This distinguished it from a "deed-poll" which was a deed by which but one party made a grant or bound himself to the other party and was so designated because the parchment on which it was written was cut straight at the top instead of being indented.

Today the term has lost much of its former technical significance owing to the fact that even where an instrument for the conveyance of land is executed by both parties, it is usual to make one instrument and deliver it to the grantee. The practice of recording deeds leads to dispensing with a counterpart.[1]

The ordinary mortgage of today is commonly called an indenture although it may be signed only by the mortgagor.

Mortgagor

Who is Jones? Jones is the borrower. He conveys or grants the land to Brown, and in that

[1] (See Birdseye's Abbott's "Clerk's and Conveyancers' Assistant," Third Edition, Note, pp. 646, 647.)

sense is called the "grantor." But since the conveyance is intended to operate merely as security for the repayment of a debt, or the performance of some other act, Jones is called the "mortgagor."

As mortgagor, Jones may be any one of lawful age, capable of owning land, and of understanding the ordinary affairs of life; Jones may be a woman, married and enjoying the right under the law to own property apart from her husband, or a co-partnership consisting of several partners or an artificial person, such as a corporation. In any event, Jones should not be under any legal disability, as such disability may afterwards be set up as a defense against Brown, as hereafter considered.

Though ordinarily Jones executes the mortgage, he may, by power-of-attorney, authorize and empower some one else to execute it. But the power to mortgage must be delegated expressly, as the right to sell the property of another does not include the right to mortgage it.

Mortgagee

Who is Brown? Brown is the lender and receives the conveyance of the land from Jones, and in that sense is called the "grantee." But since the conveyance is intended to operate merely as security for the repayment of a debt, or the performance of some other act, Brown is called the "mortgagee." As mortgagee, Brown may be any one having the qualifications indi-

cated for Jones. Brown must not be under any legal disability, as such disability might subsequently be made the basis of an action to recover his loan before the maturity of the mortgage, to the embarrassment of Jones.

Though ordinarily Brown does not execute the present day mortgage, nevertheless it may be necessary for him to do so, if he makes any personal covenants for which Jones desires his signature as evidence.

Jones may execute and deliver the mortgage, leaving Brown's name blank. The blank may be filled in later by Brown.

The address is not essential, unless required by statute, but the mortgage should identify the parties who respectively fill the positions of mortgagor and mortgagee.

The firm name of a partnership, or the fictitious name of the mortgagee capable of identification, is sufficient.

Consideration

A mortgage in order to create a valid lien on property, must be supported like any contractual agreement by a consideration passing to the mortgagor, or his authorized agent, but may come either from the mortgagee or a third party.

In the case mentioned, Brown has transferred $10,000, which is the consideration Jones has received for giving the mortgage. The consideration may be an amount of money, but need not

be in money. Natural blood and affection or family relationship may be sufficient. A mortgage may be given for a contract of the mortgagor to provide support and maintenance, or an annuity, to the mortgagee or a third person. The consideration need not pass concurrently with the execution and delivery of the mortgage. Thus the mortgage may be given to secure the payment of a prior, real, existing debt, or may be given to secure future advances which the mortgagee, or a third party, is to make. Such prior existing debt will be sufficient consideration; so, too, the future advances when made.

If, however, a pre-existing debt is the consideration, unless there is a new consideration given concurrently with the mortgage, the mortgagee will not be considered a bona fide purchaser for value, hence his lien is not entitled to equities and priorities against innocent third parties who part with value not knowing there is a lien on the property. That is, it is a general principle of contracts that a promise to do something one is already under a legal obligation to do is not legal consideration sufficient to afford the basis of a valid contract. It is sometimes called "past consideration," but from the viewpoint of the law it is no consideration at all.

And, of course, if future advances are never made, or services never rendered, in short, if the consideration fails, the mortgage fails—it is deemed never to have created a valid lien on the property.

When a note or bond accompanies the mort-

gage, the consideration paid for the note or bond will be sufficient also to support the mortgage.

The nature of the liability is not material, but the mortgagee, or a third party, must have parted with something of value, suffered some loss, expense (such as assuming the debt of another) or detriment for, or on account of the mortgagor in order to entitle him to claim the mortgage as a valid lien on the mortgagor's property.

A present day mortgage is usually accompanied by a bond or note evidencing the loan. In other words, Jones borrows $10,000 on his bond and, as security for the bond, executes a mortgage in favor of Brown. Reference to the bond is generally made in the mortgage, and also in the bond to the mortgage.

A Form of Bond to Accompany Mortgage

KNOW ALL MEN BY THESE PRESENTS, That John Jones of No. .... Street, Borough of Manhattan, City, County and State of New York, hereinafter designated as the obligor, does hereby acknowledge himself to be indebted to James Brown of No. .... Street, Borough of Manhattan, City, County and State of New York, hereinafter designated as the obligee, in the sum of ten thousand dollars, lawful money of the United States which sum the said obligor does hereby covenant to pay to said obligee, his executors, administrators or assigns, on the 15th day of June, nineteen hundred and twenty, with interest thereon to be computed from the 15th

day of June, 1917, at the rate of six per centum per annum, and to be paid on the 15th day of December next ensuing the date hereof, and semi-annually thereafter.

AND IT IS HEREBY EXPRESSLY AGREED THAT the whole of said principal sum shall become due at the option of said obligee after default in the payment of interest for thirty days, or after default in the payment of any tax or assessment for thirty days after notice and demand. All of the covenants and agreements made by the said obligor in the mortgage covering premises therein described and collateral hereto, are hereby made part of this instrument.

Signed and sealed this 15th
day of June, 1917.
In the presence of:
HENRY BULLOCK JOHN JONES (Seal)

A Form of Acknowledgment to Bond

STATE OF NEW YORK
CITY OF NEW YORK } ss.
COUNTY OF NEW YORK

On this 15th day of June, in the year nineteen hundred and seventeen before me came John Jones to me known to be the individual described in, and who executed the foregoing instrument, and acknowledged that he executed the same.

TIMOTHY SMITH,
Notary Public,
(Seal of notary) No. .... New York County.

Interest

Since a mortgage is essentially a conveyance to secure the performance of an obligation (generally the repayment of a loan), it is usual for Brown, the mortgagee, to require Jones, the mortgagor, to pay interest for the use of the money, especially as Brown will not, in all likelihood, if all goes well with Jones, ever become the absolute owner of the mortgaged property. That is, Jones will probably pay off the mortgage debt.

Interest accrues from the time money is advanced or paid out by the mortgagee. The rate, if not stipulated, is the legal rate, namely that provided by statute of the state where the property is situated.

If interest is not stipulated for in the bond, but is stipulated in the mortgage agreement, it will be allowed by the court.

Usury may be set up as a defense by individuals. Generally corporations are not permitted to take advantage of the defense of usury. Presumably the fundamental idea back of the distinction between a corporation and an individual in this matter of usury is that people who take advantage of the corporate form of doing business do not need the protection intended to be given to the individual debtor who may not have the capacity to protect himself against an oppressive lender.

The parties may later agree to a rate of interest higher than that originally stipulated,

provided the new rate is not usurious. Such a higher rate will not increase the lien of the mortgage, and equity will not enforce an agreement of this kind if made in consequence of delay in payment. The mortgagee may properly agree to accept a lesser rate for prompt payment if the rate originally agreed upon is not usurious.

Granting Clause

Under the early common law of England, the transfer of absolute ownership of land was effected by the grantor making manual delivery of a handful of earth to the grantee while standing upon the land, as symbolical of the transfer. Witnesses, not a written document, evidenced the transaction. Later, land came to be transferred by the delivery of a deed by the grantor to the grantee, and so many interests in land came to be recognized by the courts that in order to effect a transfer of the entire absolute ownership of land by deed, numerous words of grant came into use, each having a technical legal significance, evidencing the manner and character of the property rights transferred[1]

This accounts for the multiplicity of words in the granting clause of deeds and mortgages in use in those states of this country that still adhere to the forms showing their inheritance of the English common law.

In some states the use of particular words is prescribed by statute as necessary to convey the

[1] (See Granting Clause, Example 1, p. 11.)

property either by deed or by way of mortgage. If so, such words must be contained in the granting clause. In short, it is necessary to comply with the statutory requirements in order to make the mortgage instrument effective.

Description of the Property

Brown has loaned money to Jones in return for the conveyance to him of certain land. It is therefore necessary that the property be described. The description in the mortgage need not be minute, but must clearly identify the specific property intended to be mortgaged, or make reference to other documentary evidence, such as deeds or maps, preferably those on public record, from which the identification can be made. Clear identification, not mathematical exactness, is requisite.

The mortgage may describe the land as being all that Jones owns in a certain political area. In this event reference to the public records of that locality, or other competent proof, would identify the property. Similarly, if Jones agrees that all "after-acquired property" shall become subject to the mortgage.

Habendum Clause

The habendum clause (beginning "To have and to hold") describes the quantity and nature of the estate granted by the mortgage. It is impossible within the limits of this work to discuss generally the matter of "estates" in law.

Perhaps it will be sufficiently descriptive here to say that Jones may be absolute owner and mortgage his interest as such, or he may mortgage the interest he acquires by leasing land from another.

Covenants

In the strict common law mortgage of realty, described in the very beginning of this discussion, the mortgagor does not make any promise to the mortgagee. He is deemed, in the eyes of the law, to have warranted his title to the mortgage property, that is, he is deemed to have made the representation that he really is the owner of such interest in the property which he purports to convey to the mortgagee as security for the repayment of the loan, or performance of other obligation. But he has assumed no personal liability except as he is liable if his representations prove to be incorrect. As before stated his failure to perform merely results in the mortgagee becoming the absolute owner of the property mortgaged.

Today, however, it is rare that such a simple agreement will satisfy the parties. The mortgagee is very apt to make inquiry of the mortgagor as to his title and ownership of the property, and ask many other questions to satisfy himself as to the desirability of loaning his money on the strength of the contemplated mortgage. The mortgagor answering these questions satisfactorily is likely to be required to insert them in the mortgage, as representations

he has made. If they be true, he loses nothing; if they be false the mortgagee wants proof in the mortgage itself to enable him to hold the mortgagor personally liable for any loss he may have suffered by reason of the mortgagor's deception.

Then, too, as a condition to loaning his money, the mortgagee may insist that the mortgagor agree to do or permit him to do this, that, or the other thing, to afford a better security.

Similarly, the mortgagor may require the mortgagee to agree to terms which will better safeguard and protect the property while it is mortgaged in the event the mortgagee takes possession, and better insure the prompt restoration of the mortgagor's ownership upon his fulfilling the terms and conditions of the mortgage.

Such terms called "covenants of the mortgagor" and "covenants of the mortgagee" are often superfluous, as the law of the state, whether statutory or found in the decisions of the courts, would fix the rights of the parties with precisely the same result. In other words, the courts would deem the parties to have contracted with a view to the law of the state.

But it is the better and more general practice to set forth at large in the mortgage all the covenants of each of the parties.

Such covenants are for the most part purely a matter of bargain, or contract between the parties, and are governed by the ordinary rules of the law of contracts. Yet they too often bewilder the student who views them erroneously as being part of an elaborate system of

the fundamental principles of the law of mortgages.

Covenants in a mortgage, however, impose a personal liability on the party who makes the covenants. The statutes of many of the states provide that the mortgagor shall remain in possession of the mortgaged property, at least so long as he fulfills all of the terms and conditions of the mortgage. If not so provided by statute, it is common for the parties to agree that the mortgagor shall remain in possession.

The following are covenants appropriate to the mortgagor, commonly found in mortgages:

> That he will permit the mortgagee to sell the mortgaged property in the event that the mortgagor does not pay the indebtedness as provided in the mortgage or any part thereof.
>
> That he will promptly pay the full amount of the indebtedness, with interest, if so stipulated, when it becomes due.
>
> That he will pay all taxes, or assessments, levied on the mortgaged premises.
>
> That he will pay interest on the mortgage indebtedness at stated intervals, and upon failure to pay interest within a stipulated time after it falls due then the entire amount of the indebtedness shall thereupon become due and payable.
>
> That he will keep the buildings on the mortgaged premises in good repair and will not commit any waste which would lessen the value of the property.

That he will keep the buildings on the mortgaged property insured for the benefit of the mortgagee.

That the mortgagee, in an action to foreclose the mortgage, may have a receiver appointed to receive the rents and profits, to be applied to the payment of interest and the principal indebtedness secured by the mortgage.

That he warrants that he has good title to the premises.

That he will execute any further necessary assurances of his title to the property.

That any notice which the mortgagee may be required to give will be deemed sufficient notice to the mortgagor if addressed to him and mailed in any postoffice, station or letterbox.

The mortgagor may covenant as to buildings to be or not to be erected.

In some states it is permissible to insert covenants whereby the mortgagor agrees to pay a commission to the party securing the loan upon the mortgaged premises. Also he may agree to pay the fees of the attorney of the mortgagee in the event he fails to fulfill all the terms and conditions of the mortgage and it becomes necessary for the mortgagee to foreclose the mortgage, or bring an action to enforce the personal liability of the mortgagor. It is, however, contrary to public policy in some states to include a covenant for attorney's fees.

Defeasance Clause

The defeasance clause makes a conveyance otherwise absolute in its form operate as a mortgage. It provides that the conveyance shall be null and void if the mortgagor fulfills his obligation, or that the estate granted shall cease and determine, or shall revest in the mortgagor.

An instrument to be a mortgage must be a conveyance of land with a defeasance clause. It is, however, possible to have the defeasance clause a separate agreement and taken with the deed to which it refers the two instruments will operate as a mortgage between the parties.

When an absolute deed is, by virtue of a separate defeasance agreement, intended to operate as a mortgage, it is to the interest of the mortgagor as well as the mortgagee that both the deed and the defeasance agreement be recorded in order to give constructive notice to the world that the deed is intended to operate as a mortgage, and to prevent either the mortgagor or mortgagee from dealing in the property with innocent third parties to the prejudice of the other party to the instrument.

When Wife of Mortgagor a Party to the Mortgage

By the English common law a widow was entitled to a one-third interest during her life of all the lands which her husband owned (or as the lawyer more technically says "was

seized") during the marriage, and to which any children she might have had by the marriage might have been heir. This is known as "dower right." Many states in this country have by statute abolished the right of dower, but in those states where it is still recognized it becomes necessary from the mortgagee's point of view that a married woman should consent to any transfer of land by her husband by joining in the conveyance, otherwise, in the event of her husband's death, she could assert her common law right of dower against the mortgaged property to the detriment of the mortgagee.

If a man buys a piece of land and gives a mortgage back to secure the future payment of part of the unpaid purchase price, the mortgage is called a "purchase money mortgage." He can give such a mortgage without getting his wife to join to cut off her dower interest. Though she has not joined in the mortgage deed she will not get a dower interest in anything more than her husband's equity.

In the states where dower right has never been recognized or has been abolished by statute, it is unnecessary for the mortgagor's wife to join in the mortgage.

Of course, no question of dower arises in the case of a corporate mortgage.

Covenants of Mortgagee

It is not unusual to find one or more of the following covenants on the part of the mort-

gagee, if it is agreed that the mortgagee shall have full possession of the property either for the full term of the mortgage, or upon default on the part of the mortgagor to fulfill his covenants.

That he will not commit waste.

That he will keep a strict account of the rents and profits which he derives from the mortgaged premises.

That he will apply the rents and profits to the payment of interest on, and in diminution of the principal indebtedness secured by the mortgage.

That he will promptly vacate the premises upon the mortgagor fulfilling his obligations and paying the full amount of the mortgage indebtedness, with interest (if interest is provided) and execute a release to the mortgagor to enable the mortgagor to have the mortgage cancelled on the record.

Witness Clause

A final clause recites that the parties give evidence by their signatures and seals that the agreement stated is their agreement. This is called the "witness" or testimonium clause.

The Date

The date is material only for fixing the date of payment, as when the date of payment is indicated by some phrase in the mortgage such as "one year after date."

No time of payment need be specified in the mortgage. If none is stated, the mortgage debt will mature upon demand either of the mortgagor to be allowed to pay off the mortgage debt, or upon demand of the mortgagee that the debt be paid.

The mortgage becomes effective as between the parties from the date of its delivery by the mortgagor and acceptance by the mortgagee and as to innocent third parties from the date it is filed for record.

The Signature

Of course, a forged signature of the mortgagor will make the instrument void, unless ratified by the mortgagor in a jurisdiction which would permit such a ratification. He may, however, execute the mortgage with blanks to be filled in by his authority.

A mortgage lacking the signature of the mortgagor will be held valid in equity, if he acknowledges before a proper official that he executed it as his own act and deed. The mortgage, lacking his signature may not, however, be entitled to record.

Seal

A conveyance of land has always been deemed a matter of serious import, and has from earliest days been attended with many formalities. One of these has been the affixing of the seal of the grantor to the instrument conveying the property. In most states, the law requires that a

mortgage, since it is a conveyance of land, bear the seal of the mortgagor.

The seal in addition to evidencing the conveyance as the act and deed of the mortgagor, imports that he has received a valid consideration for it. But a mortgage invalid in law, for mere lack of a seal, will in equity be held to have created a lien. A mortgagor is entitled to show, despite his seal appearing on the mortgage, that he received no consideration for it.

In a few states a seal is not required.

Attestation

In many states, as further evidence that Jones has executed the mortgage, the signature of a witness, or witnesses, is required to attest that Jones executed the mortgage in his, or their, presence.

Improper attestation, in some states, invalidates the mortgage as to third parties.

Acknowledgment

In practically every state, Jones is at least required to go before a commissioner of deeds, or other official authorized to administer an oath to a party conveying land, and under oath swear that he has executed the mortgage. This is called the "acknowledgment," is written at the end of the mortgage, and is certified to by the officer who administers the oath, by affixing his signature and official seal.

When the wife of the mortgagor joins in the

conveyance, it is necessary for her also to acknowledge that she executed the instrument, and the statutes in some states require that her acknowledgment be taken separate and apart from her husband so that it may be clear that she executed the mortgage as her own free act; otherwise, in the event of her husband's death, she might assert her right of dower by seeking to have a court of equity set aside the mortgage on the ground that she executed it under fear, dread or compulsion of her husband.

The acknowledgment is generally required by statute, to entitle the mortgage to be recorded. It is essential under most statutes. If the statute does not require the acknowledgment the mortgage may be binding except as to persons not parties to it and who have no notice of it.

Delivery and Acceptance

When Jones has duly signed, sealed and acknowledged the mortgage, it remains for him to deliver it to Brown. Not only must he, or his duly authorized agent, make delivery, but Brown, or his duly authorized agent, must accept the mortgage to give it validity.

If a bond accompanies the mortgage, delivery of that also is necessary to make it effective.

Recording and Registering

According to modern practice it is then necessary for Brown to record the mortgage.

The legislature has in most states provided by statute for the recording and registering of mortgages by requiring that the recorder or register of deeds in each county shall keep suitable books for the recording of mortgages or any conveyance affecting lands situated in the county.

A party desiring to record and register a mortgage presents it at the office of the recorder or register of deeds and the clerk in charge thereupon stamps or writes the date and generally the hour and minute at which he receives it.

The mortgage is deemed to have been filed at that time.

Later the mortgage is either copied in full in the book of mortgages which the recorder of deeds is required to keep, or at least a record of it is made in a book kept for the purpose.

These books are public records, open to examination during such hours as the recorder is required by law to keep open his office.

The purpose of recording and registering statutes is two-fold. First, to give constructive notice to the world that there is a lien upon the property covered by the mortgage; secondly, to protect at law the lien of the mortgagee, or of his assignee, or transferee.

Since one who is interested in real estate can refer to the records, a failure to consult them is in a sense negligence. They are said, therefore, to give "constructive notice" of whatever is included in them.

As between the parties to the mortgage, namely the mortgagor and the mortgagee, the failure

on the part of the mortgagee to record the mortgage would not in a court of equity in any wise affect his lien upon the mortgagor's property covered by the mortgage. A court of equity would view the mortgagee as entitled to the lien created by the execution and delivery of the mortgage by the mortgagor and the payment to the mortgagor of a valid consideration.

The failure of the mortgagee, or some other party in his behalf, to record the mortgage would not, however, protect the mortgagee against the claim of some person who should part with a valid consideration and purchase the land in good faith from the mortgagor, not knowing that there was any lien or encumbrance upon it. That is, on a failure to record the mortgage, an innocent third party might acquire an intervening lien on the property.

A mortgage covering lands lying in several counties should, of course, be recorded in each county where the property is located.

Some states, notably Louisiana, require that at the expiration of ten years a mortgage shall be reinscribed so that a person need not search the mortgage records for a period longer than ten years to ascertain whether there is any valid encumbrance upon the property entitled to priority.

Recording is spreading the mortgage at large upon the record book kept for that purpose. Once such record is made it cannot be altered, but mere clerical errors on the part of the recorder or his assistant will not vitiate the lien.

In order to operate as constructive notice, however, the mortgage must comply with all statutory requirements to entitle it to be recorded.

In order to give constructive notice to third parties in the case of an absolute deed intended to operate as a mortgage, it is necessary to record also the defeasance agreement, namely, the instrument whereby the party to whom the deed is given agrees to retransfer the property to the grantor, or the party who gives the deed, upon payment of the mortgage debt.

An additional reason for recording and registering mortgages in some states lies in the tax statutes which provide that a tax shall be paid upon all mortgages before the mortgagee may bring a bill in equity or other appropriate action in court to foreclose the mortgage.

The recording fees are generally paid by the mortgagee, unless by express agreement to the contrary, as recording is for his own benefit.

Nature of Liens

Brown now has a lien on the mortgaged property.

A lien has been defined as a "legal claim or hold on property as security for a debt or charge"—a definition that expresses nothing to the uninitiated. Its meaning may become clearer by adding that the property may ultimately be taken and sold at the instance of the party holding the lien to satisfy his debt. Therefore, in the case of real property the special claim or

lien is said to attach to the land, and follows or continues to be attached to the land no matter to whom or how many times the land is transferred until the lien has been discharged by some method recognized by law.

Liens may, for convenience, be grouped into four classes, namely, statutory, common law, equitable and those created by agreement of the parties.

A statutory lien on realty is a specific claim arising by virtue of an act of the legislature. For example, the legislature in most states has declared that taxes on land shall be a lien thereon. The land is accordingly charged with the payment of taxes assessed upon it, and unless they are paid by the owner, or some other party, the land may ultimately be sold by the tax authorities and the proceeds of the sale applied to the payment of taxes. Until the taxes are paid, or the land sold and the proceeds of the sale applied to the payment of the taxes, the lien will remain an encumbrance upon the land no matter to whom it may be transferred. So, too, in many states the legislature has declared that a judgment for money rendered against a person in a civil action, shall, when filed or docketed on the judgment roll of the county clerk, become a lien upon all lands within that county owned by the person against whom the judgment has been entered, or in which he may have an interest, until such judgment has been paid or discharged by some method recognized by law.

A lien at common law is a right to retain pos-

session of property until the debt or charge of the possessor is paid or satisfied. The lien is predicated upon possession, and once possession is abandoned the lien is lost. Familiar examples of common law liens are—the right of a jeweller to retain possession of a watch until he has been paid for the repairs; the right of an innkeeper to retain the baggage of his guest until his bill is paid. Strictly, a common law lien attaches only to personalty, but the equitable doctrine, which views a mortgagee as merely holding the legal title to the property as security for a debt, and the mortgagor as the real owner in all other respects, has become so well recognized by courts of law, that to-day, in most states, the mortgagee is said to have a lien on the mortgaged property, though the mortgagor remains in possession.

An equitable lien is a lien not recognized at common law, but only in "equity." Possession is not essential. It may attach to either real or personal property, and to an estate or interest recognized either at "law" or only in "equity." In general, it may be said that whenever equity recognizes a right to a lien, it will decree that an equitable lien exists.

The lien of a mortgage is, of course, created by act of the parties and is co-extensive in amount with the real debt, or, in other words, the consideration paid by the mortgagee. It attaches as between the parties, at the time of the execution and delivery of the mortgage, but where the rights of persons not parties to the mortgage are

concerned it attaches from the time of filing the mortgage for record. In equity, however, the lien will attach as between the parties as soon as the borrower receives any money or other consideration which is intended to be secured by a mortgage, and equity will thereupon compel the borrower either to execute and deliver a mortgage, or to return the consideration. "Equity imputes an intention to fulfil an obligation, and treats that as done which ought to be done."

In the case of a mortgage given to secure future advances the lien attaches from the date when the first advance is made.

If the mortgage provides that future acquired property shall be included in the mortgage, the lien of the mortgage attaches when the title to the new property vests in the mortgagor.

The lien continues until the debt is paid, or a release is granted by the mortgagee, or his assignee, or transferee, or until the mortgagee purchases the equity of redemption, or such interest or title to the property as still remains in the mortgagor after he has executed and delivered the mortgage, or until the debt is barred by law.

Extent of Lien

The extent of the lien created on the property is essentially co-extensive with the consideration that has been given for it.

So although it is desirable that the mortgage agreement should state the true amount of the

debt secured, unless otherwise required by statute, it is essential only that a real indebtedness be stated that can be clearly identified. But in any case, the mortgagor need repay to the mortgagee only the true amount of the consideration given for the mortgage, with interest, if so agreed, in order to pay off the mortgage and discharge the lien.

Thus, if the mortgage recites that Jones is executing the mortgage to secure Brown for future advances, not to exceed $10,000, with interest, and upon maturity of the mortgage it appears that Brown has advanced various sums to Jones, aggregating but $6,000 then Jones need pay Brown only $6,000 with interest on each installment from the date when he received it, in order to pay off the mortgage debt and be entitled to have the lien of the mortgage cancelled. In other words, he could cut down his liability by showing the consideration was less than that recited in the mortgage.

The lien of the mortgage, however, will not be extended beyond the amount recited, even though the mortgage is given to secure "any and all amounts shown to be due," and it is shown that the amount justly due is greatly in excess of the amount recited. Of course, the lien will extend to cover any amount, as between the parties, as it is but fair that the lender should have security to the full extent of his advances, but the lien cannot be extended to the prejudice of third parties. For example, they may have extended credit to the mortgagor

relying upon the amount stated in the mortgage as the extent of the mortgage lien on his property. So, too, if the mortgage recites a particular class or kind of debt it is to secure, it cannot be made to stand as security for debts not strictly of the kind or class recited. But even in New Hampshire and Pennsylvania where, by statute, mortgages given to secure future advances are invalid, they will be allowed to stand as security for present advances.

If interest is stipulated for in the mortgage, the lien of the mortgage will extend to cover the interest. If, however, the mortgage agreement provides that the mortgagee will reconvey upon payment to him of a stipulated sum, no interest is allowed on such sum.

Priority of Liens

Assuming that Jones when he executed and delivered the mortgage to Brown was the absolute owner of the property, that it was free and clear of taxes, that Jones had no judgments outstanding against him declared by statute to be a lien upon real estate of a judgment debtor, what results when taxes subsequently accrue upon the property becoming, by statute, a lien upon it? Such tax statutes generally also declare that the taxes shall become a prior lien. Accordingly, the lien created by the taxes, although it accrued later than the lien acquired by Brown, as mortgagee, would, by virtue of the statute, take precedence over Brown's lien, and

the tax authorities would eventually have the right under the statute to sell the property and apply the proceeds of the sale first to the expenses of the sale and to the payment of taxes, before Brown would be entitled to any moneys on account of his mortgage.

If, however, after the execution and delivery of the mortgage to Brown some person obtained a judgment against Jones, the lien of that judgment would attach only to the interest which Jones still had in the property. For example, if the judgment was for $2000, taxes had accrued on the property amounting to $2500, and the property was sold by the tax authorities for the non-payment of taxes, the expenses of the sale amounting to $500, and the property sold for its full value, namely, $15,000, the proceeds of the sale would be distributed in the following order: first $3000 applied to the expenses of the sale and in payment of the taxes; second $10,000 to Brown to satisfy his mortgage, and the remaining $2000 applied to the satisfaction of the outstanding judgment. If, however, the property realized more than $15,000, the surplus, after paying all of the above enumerated liens, would go to Jones.

If, on the other hand, at the time Jones mortgaged the property there was already existing a judgment lien, the owner of the judgment could levy execution, that is require the sheriff to sell Jones' property to satisfy the judgment. The lien of the mortgage given to Brown would be subject to the judgment lien. And if, at any

time prior or subsequent to the execution and delivery of the mortgage, a tax lien should arise, and the property be sold for the payment of taxes, the proceeds of the sale would be devoted first, to the payment of the expenses of the sale and the payment of taxes, second, to the outstanding judgment against Jones which had become a lien upon his property prior to the execution and delivery of his mortgage, third, to Brown in satisfaction of his mortgage until he had received payment in full of the mortgage debt, and finally any surplus thereafter would go to Jones.

Relation Between Mortgagor and Mortgagee

The relation between mortgagor and mortgagee is said to be *sui generis*. It resembles in particular aspects many other relationships, but the analogy to any one other is not complete.

Brown is in some respects like a trustee of Jones' property. He holds the legal title though Jones, so long as he is not in default, enjoys the beneficial interest. But Brown has an interest in the property more than that of trustee. He has made a loan of his money and, in most cases, is receiving interest on his loan. Moreover, Jones upon paying off the loan at maturity, is entitled to have his property restored to him absolutely.

In other respects Brown is like a landlord to Jones, but Jones may have agreed that Brown shall have possession, though in most cases

Jones is, for all practical purposes, regarded as the real owner of the property and may lease it to a tenant. The analogy is far from complete.

Jones is in some respects a pledgor. He has executed a mortgage on his property as security for the repayment of a loan, and while in some states it is considered a mere pledge, "a mortgage is a pledge and more; for it is an absolute pledge to become an absolute interest, if not redeemed at a certain time; a pledge is a deposit of personal effects, not to be taken back, but on payment of a certain sum, by express stipulation or the course of trade made a lien upon them."[1]

The relationship of Brown to Jones cannot be said to be that of vendor and vendee, for there is no present sale, nor can Jones agree at the time of giving the mortgage to forego his equity of redemption to Brown. Equity will not permit such a bargain to stand, as in most cases it would be unconscionable. At least it would lay open too great a possibility of Brown becoming the owner of the property at much less than its fair value. If Jones and Brown wish to make such an agreement, they may do so, but it must be at a later date, and in such manner that it cannot be construed to be part of the same transaction, and there must be a new, valid consideration passing to Jones at the time the new agreement is made.

A mortgage is to be distinguished from a conditional sale. The latter is a purchase of land to become absolute on the happening of a partic-

[1] (Jones v. Smith, 2 Ves. Jr. 372, 378.)

ular event. A "mortgage" has a technical significance. It imports a defeasance or divesting of the title of the mortgagee. It also imports an equity of redemption. No instrument can be construed as a mortgage which does not contain these essential characteristics. Except in jurisdictions where statutory forms must be followed, they may be expressed in almost any words which clearly show the intention of the party to pledge land as security for a debt with defeasance upon payment. The distinguishing quality or attribute of a mortgage is the condition that if the debt which it is given to secure, is paid on the law day, then the conveyance is to be void, or if not, the conveyance is to be absolute at law although in equity subject to the mortgagor's equity of redemption.

One of the tests to decide whether an instrument is a mortgage or a conditional sale is to consider whether the debt came to an end with the execution and delivery of the deed. If so, the instrument is not a mortgage as there can be no mortgage unless there is a debt to be secured by it.

Trustee

Jones may execute the mortgage to a trustee instead of to Brown. This fact creates the possibility of the corporation mortgage securing corporation bonds.

Any one may act as trustee who fulfills the same qualifications as Brown. The trustee must have the additional qualification of being

impartial, as he represents both the parties to the mortgage.

The trustee cannot delegate the powers entrusted to him except mere mechanical details. If he has any doubt as to his duties, he should seek the assistance of a court of equity.

A deed of trust in the nature of a mortgage differs from an absolute deed of trust by its terms. In a deed of trust in the nature of a mortgage the mortgagor has the right of redemption while in an absolute deed of trust the property is placed absolutely out of his control.

Jones may convey the property to the party who is to act as trustee without any indication in the instrument itself that it is intended to operate as a mortgage, provided the trustee in return executes a declaration of trust acknowledging that he holds the property in trust, and the two instruments together will be deemed to constitute a mortgage. Though a trustee as a general rule is not financially interested beyond remuneration for his services for acting as trustee, which the mortgagor usually covenants to pay, he is not disqualified by having an interest in the mortgage debt.

Jones need not specify in the instrument the party or parties whose loans are to be secured by the deed of trust. It is sufficient if they can be identified by the trustee. The debt secured by a deed of trust in the nature of a mortgage is generally evidenced by a bond or note, or a series of bonds or notes, especially if Jones is a corporation and wishes to borrow money on the

security of what is, for all intents and purposes, a mortgage on its corporate property. These bonds, or notes, are independent of the statutory forms, and are governed by the general principles of the law of contracts.

The corporate mortgage is usually a deed of trust executed to a trustee who holds the legal title to the property as security for the repayment of the indebtedness which is generally evidenced by one or more bonds, or one or more promissory notes. Bonds are instruments under seal, and the notes are less formal promises to pay. In some states under trust deeds the mortgagor retains the legal title, and the trustee takes only an interest in the nature of security for the debt, for the benefit of the mortgagee. But in others, the trustee takes the legal title, while the mortgagor retains the equitable title, or equity of redemption, and the right of possession, unless it is agreed by the parties that the mortgagee shall have possession of the mortgaged property. The bonds or notes secured by a corporate mortgage usually find their way into the hands of numerous parties and the corporate mortgage generally provides that it shall stand as security for the equal benefit of all the holders of the bonds or notes.

In the event the bonds, or notes, are not paid at maturity, of course each note holder or bond holder has the same rights as Brown, the mortgagee. But as the holder of one bond or note may not know the identity of the other note or bond holders, and as the deed of trust generally

provides that it shall stand as security for the equal benefit of all of the owners of the notes or bonds, it would be extremely impractical, if not impossible, to bring all the parties into court to enforce payment by foreclosure or otherwise. This difficulty is overcome by executing the mortgage to a trustee who acts for all the owners of the notes or bonds. And for similar reasons it may be desirable to execute the mortgage to a trustee where there are several joint-mortgagees—several Browns who have jointly loaned their money on the security of the mortgage—though there be no bonds or notes to evidence the indebtedness.

The notes, or bonds, are at least assignable, even in those cases in which they are not absolutely negotiable, and the security offered by the deed of trust in the nature of a mortgage is for the benefit of the legal holder, for the time being, of the debt secured, who may be identified by his lawful possession and evidence of the debt such as the note or bond, if there be any. In short, whoever at any time owns one of the bonds gets the benefit of the security of the mortgage.

In the event that the party named as trustee by Jones in the deed of trust refuses to act as trustee the court may appoint a trustee to undertake the trust, and if the trustee should at any time for any reason become disqualified to act, or if the trustee die, the court will upon application appoint a successor trustee to carry out the trust.

In many deeds of trust a successor trustee is

designated, or one or more trustees are appointed with provision that in the event one or more cease to exist, or become disqualified to act, the remaining trustees shall have full authority.

Provision is generally made that if the holder of the note, or bond, loses it, upon his furnishing proper indemnity a new one may be issued to him. However, as a matter of law, it is open to any creditor to prove that his debt was intended to be secured by the deed of trust, since a deed of trust may stand as security for liabilities incurred under the mortgage contract and is not notice when recorded of the amount actually due upon it, as the mortgage may be drawn to secure bonds or notes amounting in the aggregate not in excess of a stipulated sum, or to an unlimited amount to be issued upon terms and conditions recited in the trust deed.[1]

Assignment of the Mortgage—Transfer of the Debt

Brown, having loaned his money to Jones on the security of Jones' property, may soon thereafter wish it repaid. If no time for payment is stipulated in the mortgage, then Brown is entitled to repayment of his loan at any time he makes demand—the mortgage maturing on that event.

Generally, however, the loan is for a specified period, and Brown cannot, so long as Jones

[1] (For a further discussion see pp. 77-79, 92-93.)

fulfills all his covenants, demand payment before the date fixed by the parties.

Brown, however, if in need of funds before that date, even though he cannot hope to obtain return of his money from Jones, may sell, assign, and transfer the debt to any one who fulfills the qualifications of a mortgagee. This sale and transfer may be effected, even without Jones' knowledge or consent, by assigning the mortgage itself to the party to whom he sells it.

According to the prevailing doctrine in this country, the assignment does not pass the legal title to the land but merely the legal title to the mortgage itself. If by any chance the mortgage debt had by arrangement between the parties been paid to Brown before he executed and delivered the assignment, the assignment would pass nothing.

Or, if the debt is evidenced by a bond, or note, the transfer of the debt may be effected by merely assigning or transferring the bond or note. The mortgage is deemed in such cases to stand as security for the benefit of the lawful owner and holder of the bond, or note, who becomes the creditor of Jones, the mortgagor, and steps into the shoes of Brown, having all Brown's rights as mortgagee.

Some states require an assignment of a mortgage to be executed with all the formalities attendant on the execution of the mortgage itself, to entitle it to be recorded; in others, a mere endorsement by Brown on the mortgage instrument to the effect that he has assigned it to a

party named is sufficient. When recorded it is constructive notice to Jones, and to the world, that the mortgage has been assigned and Jones must make payment to the assignee instead of to Brown.

Of course, it is permissible for the parties to insert a provision in the mortgage that neither shall sell, assign, or transfer their respective interests. They would be personally liable for any damage arising from making an assignment in violation of this covenant.

A regular assignment of the mortgage itself eliminates Brown from the situation entirely. He has simply sold an asset. If, however, he had made any covenants in the mortgage, other than a covenant not to assign the mortgage, he could not avoid personal liability by making the assignment—but would still be liable for the fulfillment of the obligations imposed by his covenants.

Brown, however, in order to induce a purchase of the mortgage may guarantee that Jones will make prompt payment of the mortgage debt at maturity; and if a bond accompanies the mortgage, Brown may guarantee the payment of the bond at maturity. In either case, any words of guarantee either endorsed on the instrument, or on a separate instrument making clear reference to the precise debt guaranteed, are sufficient. If a note accompanies the mortgage, Brown's mere endorsement and delivery of it would be sufficient to impose a personal liability on Brown, as endorser, according to the law of negotiable instruments.

Guaranties by mortgagees, or even by third parties that indebtedness secured by a mortgage will be promptly paid to the owner and holder of the mortgage debt at maturity are frequent. A corporation which has acquired the bonds of another corporation is very likely to guarantee them in order to sell them at a higher price by reason of the additional security afforded by the guaranty.

Sale Free and Clear of Mortgage

On the other hand, Jones may desire to take advantage of an offer by Smith to buy the property before the mortgage indebtedness becomes due. Smith may not want the property encumbered by the mortgage.

Of course, Jones cannot compel Brown to accept payment of the mortgage indebtedness before the maturity of the mortgage. Brown has invested his money, generally at interest, for a stipulated period of time, and cannot be compelled to forego the enjoyment of his investment until it matures according to the terms of the mortgage. He may, however, persuade Brown to accept repayment of the mortgage indebtedness and to grant a release which will enable the cancellation of the mortgage on the record. He is then in a position to sell the property to Smith for its full value, namely, $15,000. The transaction is generally carried out through the turning over by Smith of $15,000 to some third party in escrow. The third party is to hold the fund until he receives

a deed from Jones in favor of Smith which by its terms purports to convey the property free from the mortgage and also until he receives a release of the mortgage from Brown. The third party, moreover, agrees with Brown to pay him $10,000 as soon as Brown delivers a release of the mortgage. If these terms have been agreed to, the transfer of the papers and the funds are made concurrently. The third party hands $10,000 to Brown, $5,000 to Jones and both the deed and the release of the mortgage to Smith. Smith then files the deed and the release for record.

The simple effect of the entire transaction is that Brown has accepted payment of the mortgage indebtedness before the maturity of the mortgage and has executed a release which will enable Jones, or Smith, to obtain cancellation of the mortgage on the record. Jones has received the value of the equity of redemption, namely $5,000, the difference between what Brown had already loaned him and the full value of the property.

Sale Subject to the Mortgage

Or, before the maturity of the mortgage, Jones may wish to sell his equity of redemption—that interest in the property which remained in him after he has executed and delivered the mortgage—amounting in terms of currency to $5,000 in the example chosen. Such a sale in no wise affects Brown's interest as

mortgagor, or his claim upon the property. It is merely a sale subject to Brown's interest as mortgagee. It may be made without Brown's knowledge or consent.

As already stated, Jones is not permitted to bargain away his equity of redemption to Brown at the time of executing and delivering the mortgage. A court of equity would set aside such a bargain, as being unconscionable and contrary to equity. He may, however, by a separate, distinct transaction sell, assign and transfer his equity of redemption at a later date to any one who fulfills the qualifications of a mortgagor, or to Brown, himself, provided Brown gives him a new, valid consideration for it.

Under the strict common law doctrine Jones has nothing but an equitable interest, or estate, in the property after executing and delivering the mortgage. Such an equitable estate is not recognized in courts of common law. But the equitable doctrine has become so firmly established and so generally recognized in practically all the states of this country that courts of law have come to recognize the equitable estate, or interest, still remaining in Jones after he has executed and delivered the mortgage. In other words, his equitable estate has been given a legal status. Accordingly, Jones, instead of selling his entire equity of redemption, may execute and deliver a second mortgage on the property either to Brown, or any other person fulfilling the qualifications of a mortgagee,

and this second mortgage, though premised only on the equitable title to the property, since the legal title passed to Brown on the execution and delivery of the first mortgage, is nevertheless so well recognized at law that it may be recorded in the same manner as the first mortgage.

If Jones should execute a second mortgage even up to the full value of the property, he would still be recognized in equity as the holder of an equity of redemption, and would be entitled, upon paying off the first mortgage and the second mortgage at maturity, to get back his land.

If, however, instead of executing a second mortgage on the property, he sells, assigns and transfers his entire remaining interest in the property, i.e., his equity of redemption, then upon the maturity of the mortgage he has no right to redeem the property. That right would pass to the party to whom he has sold, assigned and transferred it. Such assignee would step into Jones' shoes. He would have the same right to pay off the first mortgage and redeem the property as Jones had before he parted with his equity of redemption.

Such disposal by Jones of his equity of redemption is called "a sale subject to the mortgage," because the purchaser buys only that interest remaining in Jones after he has executed the mortgage. This in no way affects Brown's interest as mortgagee.

If no bond or note accompanies the mortgage or there is no covenant in the mortgage that the

mortgagor will pay the principal indebtedness secured by the mortgage at maturity (in other words, if Jones has not assumed any personal liability for the repayment of the loan, since Brown was content to loan his money and look solely to the property for repayment), then Jones upon having sold the property subject to the mortgage is out of the transaction altogether, except that he would be personally liable to Brown on covenants he may have made in the mortgage, and personally liable on covenants, or representations, he may have made to the party to whom he sold his equity of redemption.

Smith, the purchaser of the property, under these circumstances would not, unless he assumed the mortgage, be obliged to pay off the mortgage indebtedness at its maturity. If he failed to do so, Brown could exercise his rights precisely as though Jones were still owner of the property. Ordinarily he would foreclose the mortgage. This procedure today generally involves a sale of the property. The proceeds of the sale would be devoted to the payment of the mortgage indebtedness and the balance, if any, would go to Smith, as assignee of Jones.

If, however, a bond or note accompanied the mortgage, or Jones covenanted to pay the principal indebtedness upon the maturity of the loan (and either one or both of course, is usually the case), he thereby assumes a personal liability. Then even though he sells his equity of redemption, he still remains personally liable for the

repayment of the loan when it becomes due. If the party to whom he has sold the equity of redemption fails to pay off the loan when it matures, then Jones as well as the property itself is still liable for its repayment. The only way he can relieve himself of this obligation is to get Brown to agree to release him from his personal liability by giving Brown a valid consideration for the release and arranging with Brown to look solely to the property for repayment of the loan. Or Jones may induce Brown to accept the bond, note or personal obligation of the purchaser in the place of Jones' own bond or note.

If Jones fails to procure a release of his personal liability, Brown may still look to Jones primarily for the repayment of his loan. Jones, so far as Brown is concerned, is primarily liable.

Smith in purchasing Jones' equity of redemption may or may not assume the mortgage. If he does not assume the mortgage, he is not personally liable for the payment of the mortgage indebtedness but, of course, the property is liable; and upon failure to receive payment of the mortgage indebtedness at maturity Brown would have his right to foreclose the mortgage and receive the first proceeds out of the foreclosure sale, the balance, if any, going to Smith as assignee of Jones.

If, however, Smith agrees with Jones to assume the mortgage then so far as Jones is concerned Smith is primarily liable to Brown to pay the mortgage indebtedness when it matures.

In some states Brown is permitted to sue Smith by virtue of the fact that Smith has bought the property from Jones and assumed the mortgage, and if Brown should be unable to collect the full amount from Smith, he may then sue Jones who has, by virtue of his transaction with Smith, become a guarantor. But if Brown should elect to sue Jones, refusing to recognize Smith's position, Jones would have the right to interplead Smith in the case. That is, upon application to the court stating the facts, namely that he had sold his interest in the property to Smith, who has assumed the mortgage, Jones could have Smith made a party to the suit. Smith would then be required to show any defense as to why the mortgage should not be foreclosed or the indebtedness paid, or else be made liable to pay any judgment which Brown might obtain against Jones. Of course, this in no wise affects Brown. He merely has Smith as another party to whom he may look for repayment of his loan, and in the event that Smith fails to pay off the judgment which he obtains against Jones, he may still look to Jones for payment.

If, under these circumstances, Jones is required to pay off the mortgage, since Smith has failed to make payment despite his assumption of the mortgage, and Jones does actually pay off the mortgage indebtedness, then Jones is subrogated to Brown's rights as mortgagee, that is, he is now entitled to hold the property as security for the repayment to him of the

monies which Smith had agreed to pay to Brown and which, on account of his failure to do so, Jones has been obliged to pay.

Payment

Upon maturity of the mortgage Brown is entitled to the repayment of his loan. He cannot compel repayment before the maturity of the mortgage, but he may demand it on the "law day." If Jones still owns the property it is incumbent upon him to pay off the obligation.

Payment should be made to Brown at his address as given in the mortgage instrument, or, if none is given, then at Brown's residence or place of business. If Brown accepts payment Jones is entitled under the common law rule to a reconveyance of the property, but under the equitable doctrine a release, signed by Brown, will entitle Jones to have the mortgage cancelled on the record. Generally a trustee has no right to accept payment; it should be made to the beneficiary.

It may be, however, that Brown will refuse to accept payment. If so, an offer to pay the proper amount will operate to discharge his lien on the property, although it will not discharge the indebtedness. This offer made in the manner required by law is called a "tender." Jones should keep the amount tendered available at all times to make the payment. In most states, to effect a complete release of the mort-

gage his proper remedy would be to bring a "bill in equity" asking the court to compel Brown to accept payment and to execute a release of the mortgage.

The tender of the full amount due on the mortgage made on the "law day" will not only operate to discharge Brown's lien on the property, but also stop the running of interest on the mortgage debt, if the loan carries interest.

If Brown has sold, assigned and transferred the mortgage before its maturity without the knowledge of Jones, and the assignment is not recorded, then Jones need only make payment to Brown to relieve himself of all liability.

If, however, Jones has actual knowledge that Brown has sold, assigned and transferred the mortgage to some other party, or has constructive notice, by reason of the recording of the assignment in the same manner as the mortgage, then it is incumbent upon Jones to make payment to the assignee.

Of course, if Jones has sold the property free and clear of the mortgage, it is incumbent upon him to make payment at the time of sale. If, however, Jones has sold the property and the purchaser has assumed the mortgage, then in order to discharge the lien on the property, it is incumbent upon the purchaser to make payment to Brown, or to Brown's assignee in case Brown has sold, assigned and transferred the mortgage. If a bond or note accompanied the mortgage, it is incumbent upon Brown, upon receiving payment of the mortgage indebtedness, to deliver

up the note, or bond, to Jones in addition to executing a release of the mortgage.

Foreclosure by Court Order
Strict Foreclosure

As already stated, by the strict doctrine of the common law, if Jones failed to pay his indebtedness on the "law day," Brown became the absolute owner of the property and Jones ceased to have any interest, or estate, in it. But at an early date courts of equity established the rule that Jones should have an opportunity to pay off his indebtedness after the "law day" and thereby redeem his property.

Since equity thus intervened in Jones' behalf, it was necessary, in order to work out complete justice between the parties, which is the aim of equity, that some regard should be had for Brown. It would be unfair for a court of equity to give Jones the right for an indefinitely long time in the future to come forward and redeem his property by paying off his mortgage indebtedness. Such an uncertain ownership of the property would be most undesirable from Brown's point of view.

Accordingly, upon Jones' failure to pay off the mortgage indebtedness on the "law day," Brown has the right, now generally expressed in statutory form, to come into a court having equity jurisdiction, and ask that Jones' equity of redemption be cut off after a day certain. The court thereupon fixes a day within which it

requires Jones to make payment of the mortgage indebtedness, and decrees that if payment is not made on or before the day so fixed, Jones' equity of redemption will be forever barred, and absolute ownership be vested in Brown. This is called "strict foreclosure."

It should be noted that a strict foreclosure simply gives Jones more time to pay his debt. Eventually unless he pays he will lose his property entirely and Brown will get it no matter what its value just as if equity had not intervened to mitigate the harshness of the strict common law rule of forfeiture on the law day.

Foreclosure by Court Order
Informal Foreclosure

Equity came to take an even more lenient view of the situation. After all, Brown is really entitled to no more than the value of his loan. If the property is worth more than that Jones should get the benefit of the greater value. So the equity courts came to require what is commonly called "informal foreclosure" whereby Jones is entitled to any value in the property over and above the mortgage debt.

In informal foreclosure, Brown as before makes application to the court that the mortgage be foreclosed. Unless otherwise provided by statute this action must be brought in the county where the property is situated. Some statutes permit it to be brought where the mortgagor resides. In any event, the validity and

effect of the mortgage are determined by the law of the state in which the property is situated. Each state has the sovereign right to prescribe the manner in which land, or any interest in land, within its boundaries may be transferred.

Foreclosure procedure in most states is regulated by statute, and the statute must be strictly followed. The procedure for a majority of the states may be summarized in general terms as follows:—Brown files in court what is known as a "bill in equity," which sets forth all the facts with respect to the mortgage, the amount due thereon, and the fact of default. Copies of the bill are served on Jones and on all other parties who have an interest in the property that might be adversely affected, or prejudiced, by foreclosure. The bill is accompanied by a summons directing them to come into court on a certain day and assert their rights, or interest in the property. This gives the court jurisdiction over the mortgage instrument, the property itself, and over all of the persons so served. On the day set Brown, together with all those who have been served with a copy of the bill and the summons, appear in court and have an opportunity to be heard.

Jones at this time may set up any defense that he may have as to why the mortgage indebtedness should not be paid, or why the mortgage should not be foreclosed. Among possible defenses might be: that he had been induced to execute and deliver the mortgage by deceit, intoxication, fraud, false representations, duress,

undue influence; that he was mentally incapacitated at the time he executed the mortgage; that the mortgage is illegal, or invalid as being against public policy, or that there was want or failure of consideration. Even though facts which constitute a good defense are proved, the court may nevertheless under some circumstances refuse to give any effect to the defense. If the court feels that Jones has been guilty of "laches," that is, has been so tardy in asserting his claims as to be guilty of negligence, equity will not countenance the defense. "Equity helps the vigilant, not the sleeper."

Unless the defense is a personal one which by law is available only to Jones, it may be raised by any party having or claiming an interest in the property.

If the defense were such as to lead the court to refuse to decree that the mortgage be foreclosed, the court might nevertheless compel Jones to pay back any money he had received as consideration for the mortgage, and thus restore Brown to his original position. "He who seeks equity must do equity."

The court may at any time, by an injunction (sometimes called "restraining order"), restrain any party from proceeding in or out of court against the property or against any other party to the mortgage, or against any party who has a claim against the property. The party who applies for the injunction must show that unless an injunction is granted irreparable harm will be done either to the property or to the rights of

one or more of the parties. The court may later dissolve the injunction if it is found that there was no exigency or that it no longer exists.

Since under an informal foreclosure Brown is not entitled to cut off Jones absolutely as in the old strict foreclosure, his bill contains the prayer that the property be sold to satisfy the mortgage indebtedness. Assuming that no valid defense has been maintained to Brown's bill, and therefore that the court sees no reason why it should not grant the prayer, it appoints appraisers to ascertain the present value of the property. Upon receiving the appraisers' report the court fixes a day (called the "sale day") on which the property shall be sold, and a minimum price (called the "upset price") below which the court will not approve the sale.

The form of the decree with respect to foreclosure sale is regulated by statute in many states, and the court is required to frame its decree that the property be sold in the precise manner prescribed. These statutes generally require that the sale be advertised for a given number of weeks in one or more papers of general circulation in the county in which the property is located, and that the notice shall include a description of the property, the place and date of sale, and sometimes also the "upset price." The court generally decrees that the sale shall be for cash, but may permit the property to be sold for credit, or for part cash and part credit, generally depending upon the consent of the mortgagee. In the case of the cor-

poration mortgage the court generally fixes the price at which the bonds secured by the mortgage will be received in payment, or at least in part payment of the mortgaged property.

The sale must be conducted in strict accordance with the decree by the officer vested by statute with authority to sell property at foreclosure sale. Payment by the purchaser must also be made in strict accordance with the terms of the sale. Any material variation from the decree will afford grounds on which the party aggrieved may have the court set the sale aside, in which event the court generally orders a resale on some subsequent date.

The proceeds of the sale constitute a fund which the court then distributes in satisfaction of the lien, or liens, on the property, in the order of their priority, as heretofore considered.[1]

A prior lien must be paid off in full before the next succeeding lien receives anything, and if there are a number of liens of equal rank, and the fund available is not sufficient to pay all in full, then each receives its pro-rata share. If, however, the liens are of successive priority, or rank, and the fund becomes exhausted before all are paid, the liens which, by reason of their inferiority, or lack of priority, fail to participate in the distribution of the fund are nevertheless cut off by the foreclosure sale. In other words, the parties owning them lose, because the property did not sell for a sufficient amount to convert their "equity," or interest in the prop-

[1] (See pp. 41-43.)

erty, into cash. Their only recourse against such a contingency is to buy in the property at the foreclosure sale. Any surplus, remaining after paying off all liens, goes to Jones. This is the distinguishing feature of informal foreclosure.

When Brown files his bill in equity praying that the mortgage be foreclosed, or at any time thereafter before the final disposition of the property by foreclosure sale and distribution of the proceeds of the sale, the court may, in its discretion, upon application of any party who can show that he has an interest in the mortgaged property, appoint a "receiver." The duties of the receiver are prescribed by the court. In general they are to manage the property to the best interest of all the parties concerned, to receive the rents and profits, i.e., the income derived from the property, to pay the expenses of managing or operating the property upon order of the court, and to retain any surplus for distribution by direction of the court.

It may be that the rents and profits are not sufficient to conserve the property to the best interest of those who have liens upon it, whereupon the court may, in its discretion, authorize the receiver to borrow money and to issue receipts therefor, called "receiver's certificates." These certificates become a lien by order of the court upon the proceeds of the sale of the mortgaged property, and the court may, after all parties interested are given opportunity to be heard, direct that the lien of the receiver's

certificates shall take precedence over any or all liens upon the property, excepting the expenses of the foreclosure sale and tax liens.

The mortgagor cannot become a purchaser at foreclosure sale, at least if there are junior liens or encumbrances which he might thereby cut off. And no one who has a duty to discharge the encumbrance can be a purchaser, or any one who holds a position of trust toward the mortgagor.

The purchaser at foreclosure sale receives a deed of the property executed by the party or official designated by the court, or by statute, generally by statute, and becomes the owner of the property the same as any other purchaser, subject in some states to Jones' "right to redeem." This "right to redeem" will be considered later.[1]

Foreclosure by Power of Sale

The mortgage may contain a provision that upon failure of Jones to fulfil his covenants as stipulated in the mortgage, thereby precipitating maturity of the mortgage indebtedness, or upon his failure to pay the mortgage indebtedness when it falls due, Brown shall have the right to sell the property free and clear of Jones' equity of redemption. This covenant gives Brown the right to sell the property and convey absolute title without being obliged to make application to the court to cut off Jones' equity.

If Brown is given this power of sale, he can sell the property only in strict accordance with

[1] (See pp. 72-73.)

the terms specified in the mortgage. The power of sale generally requires Brown to apply the proceeds, first to the expenses of the sale, next in satisfaction of the mortgage indebtedness and any other liens that may be outstanding against the property, in the order of their priority, and to pay over any surplus remaining thereafter to Jones.

This power of sale by the mortgagee is forbidden by statute in some states, but in the states where it is permitted, it is generally considered a "cumulative remedy," that is, an additional remedy which Brown may elect, or he may make application to the court and have the mortgage foreclosed by court order.

Precipitating Payment—Events of Default

There may, however, be circumstances which, under the terms of the mortgage, will make the mortgage indebtedness become due and payable before the "law day."

The mortgage may contain covenants of the mortgagor providing as a penalty for a breach of the covenant that either upon the occurrence of the breach or in the event the breach continues for a stipulated period, generally 30, 60 or 90 days, the mortgagee may thereupon declare the entire mortgage indebtedness due and payable. A breach of covenant involving such a penalty is called an "event of default." The events of default most commonly found in mortgages are: failure to keep the covenant to pay interest at the stipulated periods during the

term of the mortgage when they become due; failure to pay taxes, often with the alternative that should the mortgagor fail to pay taxes on the mortgaged property and such default should continue for the period of time specified in the mortgage, the mortgagee may pay the taxes himself and add them to the principal amount secured by the mortgage; similarly, failure of the mortgagor to pay insurance on the mortgaged premises.

The mortgage also may provide that the mortgagor shall not commit waste, i.e., damage, or voluntarily lessen the value of the mortgaged premises, and upon his so doing the entire mortgage indebtedness shall become due and payable. This is a less common event of default. It is open to the parties to stipulate what shall be considered "events of default," and what penalties shall be suffered. Of course, the mortgagee may waive any event of default.

Deficiency Judgment

There can be no deficiency judgment or requirement that some one make good any balance due on the claim beyond the amount realized for the property on the foreclosure sale, unless some person is personally liable either on a covenant in the mortgage, or on the bond or note accompanying the mortgage, or by virtue of having purchased the property and covenanted to assume the mortgage.

If a bond or note accompanies the mortgage,

the mortgagee, or the lawful owner or holder of the mortgage debt at the time it matures is, in many states, given the alternative of suing the party liable on the note or bond in an action at law, or of bringing a bill in equity to have the mortgage foreclosed. In some states it is possible to bring both actions concurrently, but in most states a court of equity obtaining jurisdiction by the filing of a foreclosure bill, will enjoin any action on the bond or note accompanying the mortgage, as being vexatious and superfluous to its own determination of the entire matter. The note or bond must be construed with the mortgage, but the mortgage being mere accessory must give way to the note or bond which is the principal thing, and governs as to the terms of the debt, interest, and time of payment. Even in those states in which the mortgagee is permitted to exercise both his remedies on the bond or note and his remedy against the property concurrently, and is successful in both, of course only one satisfaction of the mortgage indebtedness is allowed. As soon as the mortgage indebtedness has been satisfied either as a result of the foreclosure and sale of the property, or by payment of the judgment recovered on the bond or note, no further recovery can be had.

If Brown, or his assignee, elects to have the property foreclosed and the property does not sell for an amount sufficient to pay off the mortgage indebtedness in full, together with costs of the litigation imposed by the court, the expenses

of the sale, and any taxes or other prior liens upon the property, then Brown, or his assignee, in most states, is entitled to a judgment for the deficiency against any or all persons who are personally liable to pay the mortgage indebtedness. For example, assume that the property brought at foreclosure sale only $8,000 and that Jones was personally liable either on his covenant in the mortgage to pay the mortgage indebtedness, or on a note or bond accompanying the mortgage, then he would be liable for the deficiency amounting to $2,000 together with the costs of the litigation imposed by the court, the expenses of the foreclosure sale, and interest on the mortgage debt, if the mortgage provided for interest. If, on the other hand, the property should sell for $11,000 Jones would be entitled to receive any surplus after the costs of the litigation imposed by the court, the expenses of the sale, and the mortgage indebtedness had been paid. If, however, Jones had sold the property to Smith subject to the mortgage and Smith had assumed the mortgage, then Smith would be primarily liable to make up any deficiency. If Smith, however, should fail to pay, Jones as guarantor, would have to make good the deficiency. But if there was a surplus it would go to Smith.

Redemption

The equity of redemption must be distinguished from the phrase "right to redeem." The former is Jones' estate, or interest, in the

property after he has executed and delivered the mortgage. The latter is a right given Jones by statute to redeem his property from the purchaser at foreclosure sale within a period of time fixed by the statute. In many states this privilege, granted to the mortgagor by statute, cannot be curtailed by the court, although Jones may waive it. If he has not waived it and elects to take advantage of the statutory right to redeem after foreclosure sale, the purchaser, upon receiving payment from Jones of the full amount he has paid out, with interest, must execute a deed transferring the property to Jones. Other parties having an interest in the property may enjoy the right to redeem, if the statute permits. The right is not given to a stranger or mere volunteer. The statutes generally limit the right to redeem the property after foreclosure sale to a short period of time.

If, however, Brown, or his assignee, has not foreclosed (and he cannot be compelled to seek foreclosure), Jones' right to redeem the property is generally limited to twenty years by another statute, common to most states, called the "Statute of Limitations." And similarly Brown is limited by this statute to a period of twenty years after maturity within which he may apply to the court to have the mortgage foreclosed.

PART II

THE CORPORATION MORTGAGE

The basic principles of law relating to mortgages are for the most part of ancient origin. They were well known to the English courts in earliest times. The evolution of these principles was coincident with the development of the English law relating to property. They have undergone development by the English courts, and have been further developed and modified by the courts and legislatures of those of our states that have inherited the English common law.

The principles of the civil law relating to mortgages, that obtain in a few states are of even more ancient origin.

In early English times the king owned the realm. The right to hold property was derived from the king—the sovereign power. This was the basic foundation of the feudal system of land tenure, giving rise to the different estates in land known to the English law, the pledging of which, as security for the repayment of a loan, developed that body of principles commonly referred to as "the law of mortgages."

The principles of law relating to corporations

have the same, though later, origin, and somewhat analogous history. The right of several individuals to combine and engage in an enterprise with limited liability to themselves was originally a privilege granted by the king, and the modern corporation owes its existence to the charter or franchise derived from the sovereign power which in this country is the State.

Until comparatively recent date, individuals desiring to do business in corporate form made personal petition to the legislature for a franchise or charter which was granted by "Special Act of the Legislature." This Act set forth the conditions and restrictions under which the State would permit the business to be carried on. Rarely was the right to mortgage included in the franchise. This method of obtaining a franchise has been supplanted in most states by the enactment of general laws, upon compliance with which a corporate charter or franchise may be obtained, and the right of the corporation to mortgage its property, if applied for, is granted as a matter of course. But it is worthy of note that the right of a corporation to borrow money and acquire property in excess of its authorized capital, by the issuance of bonds, was challenged in New York State as late as the year 1844, in the case of Barry against Merchants' Exchange Company (1 Sandf. Chancery, N. Y. 280-312), and given serious consideration by the court as late as 1857, in the case of Curtis against

Leavitt (15 N. Y. 1, 51-62), and that the right to include the franchise in a mortgage of property to secure the repayment of a loan did not become general law in New York, in the case of railroads, until 1850.[1]

A mortgage by a corporation on a single piece of its real estate to an individual mortgagee need differ but slightly from the simple forms heretofore indicated.[2] The difference lies only in the substitution of the corporate name for that of the mortgagor, and in the manner of the execution and acknowledgment of the instrument.

Generally, however, when we use the term "corporation mortgage" we refer to a transaction somewhat different in form. If the amount to be borrowed on the security of the mortgage is too large, as it usually is, to be loaned by a single investor, the corporation must seek the funds of many lenders. Without discussing the reasons why other conceivable methods of giving a multiplicity of lenders the same mortgage security are impracticable, it will be enough for the purpose of this treatment of corporation mortgages to state the one practicable method that is regularly followed. The mortgagor corporation makes a mortgage which in form mortgages the property to an individual, or to two individuals, or more

[1] (See "Preparation of Corporate Bonds, Mortgages, Collateral Trusts and Debenture Indentures," by Francis Lynde Stetson, page 4 of "Some Legal Phases of Corporate Finance and Reorganization" [MacMillan Co., 1917].)

[2] (See Examples 1 and 2, pp. 11-14.)

commonly, to a trust company, or sometimes to a trust company and one or two individuals. Assume that the mortgage is made to a trust company. Though in form the trust company is the mortgagee, it appears that it is mortgagee not to secure a loan it has made but to secure the loans made by a multiplicity of people who receive the bonds of the corporation as evidences of their rights as creditors of the corporation. The trust company is mortgagee for the benefit of the bondholders. The position it occupies in the transaction is called that of "Trustee." It is not to be assumed, however, that its position exactly corresponds with that of the trustee of an estate left by a will who is charged with the duties of managing the estate. The trustee under a corporation mortgage, as will be seen, does not accept a responsibility of this kind. In essence, unless and until the corporation defaults in its obligations to the bondholders, the trustee has no active part to perform excepting purely formal administrative duties. The position, as such, merely makes possible a legal device by which a multiplicity of lenders may receive the benefit of the security of a single mortgage. The mere fact that a responsible trust company is trustee other than as fulfilling this formal legal function means little in relation to the essential value of the security. It may be said, however, that the trustee may agree to exercise a very considerable supervision in seeing that the security is properly maintained and probably would be

willing to do so if compensated for service of this character. As the sentiment of bondholders that such services are desirable develops probably the trustee will come to fulfill more than merely nominal duties.

Why then, it may be asked, do not these simple forms of corporate mortgages obtain today? Generally, the investor lacks that personal knowledge that all of the necessary steps have been taken to entitle him, as purchaser of a note or bond, to a valid lien on the property of the corporation. This has led to the insertion of numerous recitals in the present day corporate mortgage to the effect that all such necessary steps have been taken. The fact that the precise duties and liabilities of a trustee are not always to be found in the written law, and the degree of his discretion may be made the subject of litigation, has led to the insertion of many other provisions respecting the trustee. Bitter experience with corporate mortgages due to lack of explicit provisions, the tremendous progress, with increasing complexity, in corporation law and corporation finance in the last decade or two, and many other factors, have contributed to the evolution of the present day mortgage or pledge of corporate property into an elaborate and complex instrument, frequently requiring in printed form some 200 pages.

It would be futile to attempt to analyze all of the great variety of provisions that are to be found in the corporate mortgage as it stands

today. Besides those provisions directly expressed there are those implied by virtue of the fact that the instrument creates a lien on real property situated within the jurisdiction of a particular state, according to the laws of which the validity and effect of the instrument must be determined.

The following pages are intended to facilitate recognition in the corporate mortgage of the principles of law already enunciated in the discussion of the ordinary simple mortgage on real estate between individuals as mortgagor and mortgagee, and to promote that familiarity with the corporate mortgage which the bond salesman should have to enable him to understand intelligently the true nature of the "goods" he sells, and thereby enable him the better to represent his employer, the investment banker. It is believed that they will prove helpful to the investor, whether as stockholder, that he may more intelligently determine the terms upon which he will authorize his company to borrow money, or as bondholder, that he may determine more readily the true nature of the security offered for the return of his money: and in general it is hoped they will dispel for the enquirer the sense of mystery which at present surrounds the idea of a corporate mortgage in the mind of most laymen.

The Technical Name of the Instrument

The typical corporate mortgage is properly called an "indenture" because it is executed

both by the corporation (the mortgagor) and also by the trustee, or trustees, accepting the trust. Hence, the usual opening words of the corporate mortgage "This Indenture" properly describe the instrument.[1]

The Date of the Instrument

Then follows the date of the instrument, a matter already discussed.[2]

The Names of the Parties

Next in order the names of the parties to the indenture appear, to wit: the corporation (the mortgagor), more expressly identified by adding a phrase designating the state under whose laws it is organized, party of the first part, a more concise designation of which is provided by the parenthetical phrase—"(hereinafter called 'the Company');" and the trustee, which, if a trust company, is likewise further identified by designating the state under whose laws it is organized, party of the second part, and also a more concise designation is provided by inserting the parenthetical phrase—"(hereinafter called 'the Trustee')."

Since the trustee accepts the trust in behalf and for the equal benefit of the lawful owners and holders of the bonds secured by the mortgage, it is unnecessary that the owners or holders of these obligations execute the mort-

[1] (See p. 15.) [2] (See pp. 30-31.)

gage. The mortgage expressly provides that they shall become parties to the agreement and be entitled to the benefit of the lien created thereby, by the purchase and acceptance of the bonds which the mortgage is intended to secure.

There may, however, be more than one trustee. If it is desired that a trust company shall perform most if not all of the duties of administering the trust, at least prior to a default on the part of the mortgagor corporation, it is often necessary to add an individual trustee resident in the state in which the mortgaged property is situated, in order to comply with statutory requirements. The trustees, if more than one, are collectively, however, designated as "parties of the second part" to the indenture. There may also be a third party to the indenture, viz., the guarantor. More frequently the guaranty arises out of a subsequent transaction and the guarantor company merely endorses its guaranty on the face of the bonds or notes and does not become a signatory party to the indenture. But sometimes the guarantor becomes an actual signatory party to the indenture. This matter depends on the origin and history of the particular transaction.

"Whereas" Clauses

A number of clauses beginning with the word "whereas" follow the naming of the parties. These clauses are sometimes collectively referred

to as the "Preamble." It is not essential to the validity of the corporate mortgage that they be set forth in the indenture, but they are intended to show that the necessary steps have been taken to lay the proper foundation which is essential to the validity of the mortgage. The "whereas" clauses are to be deemed representations on the part of the corporation which the law will not permit the corporation after the execution and delivery of the indenture to deny (what lawyers call an "estoppel"), and they may be made the basis of a civil action by any one who has been damaged by relying on the good faith of the representations. Though these clauses vary in form, substance, and number in most every corporate mortgage, they may be described in general terms as follows:

(1) A clause reciting that the company is duly incorporated and organized under the laws of some particular State, followed by a brief summary of its corporate purposes and powers.

(2) A recitation to the effect that the corporation is duly authorized by the laws of the State under which it is incorporated, to mortgage its realty and, in most cases, its personal property, and in some cases, also, its franchise. This clause need only recite authority to mortgage such of its property as is included in the mortgage. If personal property, or the franchise, is not included in the mortgage it is super-

fluous to recite that the corporation has power to mortgage them.

(3) A clause reciting that the board of directors of the company, at a meeting duly called, resolved for the purpose of borrowing money for lawful corporate purposes to create an issue of bonds (specifying whether they are to be registered or coupon, or both), or a series of notes, to an amount not to exceed in the aggregate the principal sum stated, to be at any time issued and outstanding, or to an unlimited amount "upon the terms and under the conditions hereinafter set forth," the name in brief by which the issue of bonds or notes shall be designated, how, when and where payable, the rate of interest, the dates on which and the place where interest shall be paid, and, if the company is to have the option of redeeming the issue in whole or in part, the price at which, and the time, place and manner in which the option may be exercised by the company.

(4) If the corporation is a public utility, it may be necessary that permission be obtained from a public service or other commission, or commissions, to create an issue of bonds or notes to be secured by a mortgage, in which event it is proper to recite that the necessary certificate authorizing the company to issue the bonds or

notes has been obtained from the public service or other commission.

(5) That the board of directors has by further resolution authorized and directed that the bonds (or notes) "be in substantially the form following"—(Form of the bond or note is then set forth in full.)

(6) If provision be made for both coupon and registered bonds, the form of coupon bond being set forth in the preceding clause would be followed by a similar paragraph pertaining to the registered bond. (Form of the registered bond is then set forth in full.)

(7) If provision is made for interest coupons to accompany the bonds or notes, there may follow a clause reciting a similar resolution with respect to the interest coupon. (Form of the interest coupon is then set forth in full.)

(8) If provision is made for the bonds or notes to be certified by the Trustee (which today is the rule almost without exception), a resolution approving the form of the trustee's certificate follows. (Form of Trustee's certificate is then set forth in full.)

(9) If the bonds or notes are to be guaranteed by another corporation there may follow a resolution approving the form of guaran-

tee which the guarantor company is to endorse on the bonds or notes and interest coupons. (Form of guarantee is then set forth in full.)

Or there may be a clause reciting the fact that the issue of bonds or notes are to be guaranteed as to payment of principal and interest by the guarantor, reciting the consideration moving to the guarantor for the guaranty, and the form of the guaranty to be set forth in a subsequent article in the indenture relating to the guaranty.[1]

(10) Recitation of a resolution of the board of directors ordering and directing that in order to secure the said bonds or notes in accordance with the tenor and effect thereof, "a mortgage and deed of trust in substantially the form of this indenture and containing all the covenants, conditions and provisions contained in it," specifying which officer is authorized to execute the same in the name and on behalf of the company, and the officer who shall attest to the affixing of the corporate seal, also the manner and to whom, as trustee, the indenture shall be delivered on behalf of the company.

(11) A clause reciting that the stockholders have by resolution, at a meeting duly called for that purpose, ratified all of the aforesaid resolutions of the board of directors and

[1] (See p. 121.)

authorized and directed the execution and delivery of an indenture of mortgage and deed of trust in substantially the form approved by said resolution of the board of directors.

The by-laws of a corporation generally forbid any mortgaging of the corporate property except by order of the board of directors, upon consent of either a majority, or two-thirds or three-fourths of the stockholders (rarely requiring that the consent be unanimous) at a meeting of the stockholders duly called for that purpose. Action of the stockholders may then precede any action on the part of the board of directors, in which event the "whereas" clauses would be phrased accordingly. It is only necessary that the mortgage be executed pursuant to authority obtained in accordance with the by-laws of the corporation. But it is the better and usual practice for the directors, who are in closer touch with the needs of the corporation, to lay before the stockholders the form of mortgage which it is proposed to execute, and the form of bonds, notes or other obligations to be thereby secured, for approval and ratification by the stockholders, as this precludes the possibility of subsequent repudiation of the mortgage and the obligations thereby secured by the stockholders on the ground that the board of directors exceeded or abused the authority delegated to them. And, of course, the form of the bonds, or notes, as well as the

form and contents of the indenture should be consistent with the "whereas" clauses.

Whatever the precise form, contents, or number of the "whereas" clauses, in any event they are intended to show what is frequently recited in a final "whereas" clause, that all things necessary to make the bonds (or notes or other obligations) when authenticated by the trustee, the valid, binding and legal obligations of the corporation and to constitute the indenture a valid, binding and legal mortgage and deed of trust for the security thereof, and to provide for the authentication and enforcement of the payment of the said bonds, have been done and performed, and the execution and issue of the said bonds and of the indenture have in all respects been duly authorized.

Granting Clause

The "whereas" clauses are followed by the proper granting clause, setting over to the trustee the mortgaged premises, generally acknowledging a nominal consideration paid by the trustee to the corporation, and reciting that the further consideration is the purchase and acceptance of the bonds to be secured by the mortgage.

If there is a statute prescribing the use of particular words as necessary to convey the property, they must be included in the granting clause of the corporate mortgage just as in the case of a mortgage by an individual.[1] Essen-

[1] (See pp. 22-23, and note, p. 22.)

tially the real consideration is the value which the corporation receives for the bonds. The result, then, is that the mortgage stands as security for the payment of the bonds issued and outstanding in accordance with its provisions.

Mortgaged Premises

Following the granting clause is the description of the property mortgaged.[1]

Real Estate

This may consist of one or more parcels of realty generally described in detail, by metes and bounds.[2]

Personalty

Personalty may be included in the property mortgaged. The items are either described in detail, or embraced in an omnibus clause.

Other Mortgageable Property

The property mortgaged may also include liens, leases, leasehold rights, easements, franchises, and privileges creating an interest in land. Similarly these are enumerated and separately described, or grouped together in one clause beginning with the word "All."

Patents

Patents also may be included in the mortgaged property by description in detail, having

[1] (See p. 23.) [2] (See p. 23.)

reference to the letters patent, or by description in full in a separate instrument of assignment executed to a trustee simultaneously with the execution of the mortgage and deed of trust to the same extent and in the same manner as though they had been fully set forth in the mortgage.[1]

Stocks and Bonds

If the corporation owns stocks or bonds or other obligations of other corporations which it desires to pledge as security for the repayment of a loan, and the property pledged consists entirely of such stocks, bonds or other obligations, the instrument is properly to be called a "collateral trust agreement." Such agreements are subject to the principles of law relating to pledgor and pledgee. But not infrequently a corporation will execute, simultaneously with the execution of a mortgage, a collateral trust agreement transferring such collateral to a trustee to be held in trust in all respects subject to the provisions of the mortgage and deed of trust to the same extent and in the same manner as though the collateral were fully described in the mortgage.

Strictly, when realty is mortgaged, only such property should be included in the mortgage as by law may pass as appurtenant to land.

[1] (Remington Typewriter Company to Columbia Trust Company, Trustee, First Mortgage, dated January 1, 1916, recorded January 14, 1916, securing $7,500,000. First Mortgage, six per cent, convertible gold bonds.)

Personalty should properly be included in a chattel mortgage which is subject to somewhat different rules of law, for the most part statutory.

Similarly, stocks, bonds and other choses in action, should be pledged by an instrument of assignment, since they are governed by again different rules of law.

But both realty and personalty are essential to the corporate business, and the mortgage security depends largely for its value on covering all the property necessary to conduct a going enterprise. So far has this been recognized in the case of railroads that "the statutes of many states declare the appurtenant chattels of a railroad to be real estate for mortgage purposes,"[1] and the requirements of the investor have become so exacting that today the property passing to the trustee under a corporate mortgage and deed of trust consists more frequently than not of realty, chattels and choses in action. The indenture, then, is a composite mortgage of realty, chattel mortgage, pledge and instrument of assignment.

Habendum Clause

The appropriate "habendum clause"[2] follows the description of the mortgaged premises.

[1] (See p. 30 (Stetson's article) of "Some Legal Phases, etc.," note 1, p. 77.)

[2] (See pp. 23-24.)

Since the modern corporate mortgage is almost invariably made to secure an issue of bonds, or notes, which by sale and purchase become widely distributed, it is expedient, for the reasons already discussed,[1] that it be executed to a trustee, or trustees, to hold title to the mortgaged premises for the benefit of the lawful holders and owners of the bonds or notes. The precise terms on which the trustee is to hold the property are set forth in one or more paragraphs called the "declaration of trust." The following are terms generally to be found: that the trustee shall hold the mortgaged premises for the equal and proportionate benefit of all present and future holders of the bonds issued under, and secured by, the indenture, for the enforcement of the payment of said bonds, and of the interest thereon, when payable, and the performance of and compliance with all the terms, covenants, and conditions of the indenture, without preference, priority or distinction as to lien or otherwise of any one bond over any other bond issued under the indenture by reason of priority in the issue or negotiation thereof, or by reason of the purpose of its issue, so that each and every bond issued or to be issued under the indenture shall have the same right, lien and privilege under and by virtue of the indenture, and so that the principal and interest of each bond shall, subject to the terms

[1] (See pp. 45-49, 77-79.)

of the indenture, be equally and proportionately secured thereby, as if all had been duly issued, sold and negotiated simultaneously with the execution and delivery of the indenture. It is also stipulated that the bonds shall be executed, authenticated, and delivered, and that the mortgaged premises be held by the trustee, subject to the further covenants, conditions, uses and trusts thereinafter set forth; and it is covenanted between the parties for the benefit of the respective holders, from time to time, of bonds issued thereunder, "as follows": In this manner, all the covenants, terms, and conditions that follow are made pertinent to the trust. Among these are particular covenants on the part of the corporation, and of the trustee, but they are made a part of the trust by a covenant on the part of the trustee, accepting the trust, to perform or cause to be performed the same agreeably to the terms and conditions of the indenture.

These terms and conditions may be, and for convenience generally are, grouped into articles, further classified into sections containing provisions relating to the same topic.

Execution and Registration of Bonds (or Notes)

The first of these articles may appropriately contain, under the above heading, the details which are for the most part a matter of bargain between the parties, relating to the form of the

obligations to be secured by the indenture, to wit,

name,
date,
place of payment, and
denomination of bonds,
endorsement on registered bonds,
execution and authentication of bonds,
signature of bonds,
authentication of coupons and interest payments,
trustee's certificate,
agency for registration,
registration of bonds,
exchange and transfer of bonds,
numbering exchanged bonds,
charge for exchange and transfer,
bonds mutilated, destroyed or lost,
temporary bonds.

It is essential that the obligations, i.e., the bonds or notes, and interest coupons, if any, shall be substantially of the same tenor and purport as set forth in the resolution of the board of directors and approved or ratified by vote of the stockholders of the company. Otherwise their validity and right to the benefit of the lien created by the mortgage would be open to attack.

In some corporate mortgages the form of the obligation is at this point again set forth in full, though this seems unnecessary repetition in a necessarily lengthy instrument, when mere

reference to the form recited in the preamble will serve equally well.

The essentials of a bond, or note, are:

(a) an absolute promise to pay
(b) a sum certain
(c) at a time certain (the validity of the bond, or note, is not vitiated by inserting provisions which may hasten the date of payment)
(d) to a person capable of being identified
(e) duly signed by the obligor, or payer
(f) and, in the case of a bond, sealed by the obligor.

And, of course, to create an obligation, the instrument must be delivered.

In order that the bond or note may enjoy the security of the lien created by the mortgage adequate reference to the mortgage is made on the face of the bond or note. This reference also states that the terms and conditions of the mortgage trust deed are made part of the bond. The bondholder may find his rights much modified in this way.

In order to avoid constant repetition of the words "bond or note," hereafter whenever the word "bond" is used as referring to the obligation secured by the mortgage, the word may be taken to imply the alternative of "note." Corporation notes secured by a mortgage are as a matter of fact in legal contemplation usually

bonds, that is, they are instruments under seal. The word "note" is taken in its acceptance on the street to indicate a short term as distinguished from a long term instrument.

Name of the Issue—Denominations

For the future convenience of the parties the name in brief by which the issue shall be designated is stipulated by the parties. And for the convenience of the investing public the bonds are frequently issued in several denominations.

Place and Medium of Payment

Provisions pertaining to payment are a matter of bargain between the parties, it being important that the company know the amount and medium of currency it shall be obliged to pay to fulfill its obligation, and that the investor know precisely what he is to receive as repayment of his loan. The law is only concerned with ascertaining the real agreement between the parties, which is greatly facilitated if clearly and definitely stated. When it is contemplated that a considerable part of the issue may find its way into the hands of owners living over a wide territory, or in one or more foreign countries, it is usual to provide for the payment of the principal and especially payment of interest at two or more places reasonably accessible, to meet the convenience of the owners living in that part of the world. For the same reason, the bonds may be issued in one or more

foreign languages. The rules of the New York Stock Exchange require that bonds to be listed on the New York Stock Exchange must in any event be made payable in the Borough of Manhattan, New York City, either by express provision in the indenture, or by supplemental agreement with the applicant for listing.

The medium of payment is also a matter of express agreement and of importance to all the parties, especially the investor. Usually the agreement is that the principal and interest on the bonds shall be payable "in gold coin of the United States," adding as a precaution against a depreciated currency, that it shall be "of or equal to the present standard of weight and fineness."

When the mortgage gives the bond or noteholder the option to receive payment of principal and interest in a foreign country, provision is frequently made that payment shall be made in the currency of that country, at a fixed rate of exchange, which is either stipulated in the mortgage, or in the bond and in the interest coupons, if any, stating the respective amounts due thereon in terms of the foreign currency in which they are payable. Otherwise, the negotiability of the obligations would be destroyed.

As further precaution against dispute, as well as an inducement to the investor, it has been frequently provided that the company shall pay the amount stipulated "without deduction for any tax or taxes which the Company may be required or permitted to pay thereon, or to

retain therefrom, under any present or future law of the United States of America, or of any state, county, or municipality or other taxing authority therein." This stipulation need be set forth only in the bond, as it must be kept in mind that the bond is the principal obligation, and the mortgage is accessory thereto. And this stipulation has to do with the principal obligation of the company. It may, however, consistently appear as an express stipulation in the indenture. This provision creates the so-called "tax covenant bonds" and has become of special interest since the enactment of the Federal income tax law. It would not be expedient now to insert this covenant without limitation.

The Date of the Bonds

The date of the bonds is also expressed, coupon bonds and notes generally bearing even date with the indenture, while registered bonds are dated on the day when they are issued. This provision is for the purpose of fixing the date from which interest shall accrue.

Registered and Coupon Bonds—Endorsement on Registered Bonds

For the convenience of the investor, it is quite usual for a corporation to provide in the mortgage for the issuance of its bonds both in registered and coupon form. The effect of these different forms is to be found in the

principles of law relating to the negotiability of instruments—not in "the law of mortgages."

The principal and interest due upon a registered bond is payable to the party whose name is registered on the books of the corporation as being the owner thereof and to such person only. To effect a change of ownership which the company is bound to recognize, it is necessary that the registered owner, i.e. the person whose name is registered on the books of the company as being the owner of the bond, shall surrender his bond to the company for cancellation and the company will thereupon at his request issue a new bond to the person he designates. Under some indentures transfer of ownership of a registered bond may be effected without the cancellation of the old and the issuance of a new registered bond, by merely making a notation of the transfer and registering the name of the new owner on the books of the company and similarly on the bond presented for transfer. The company is not bound to recognize any transfer of a registered bond unless the change in ownership has been registered on the books of the company, as stipulated either on the face of the bond, or in the indenture, or in both. Furthermore, the company fulfills its obligation as to payment of both principal and interest on its registered bonds when it makes payment to the person whose name is registered on its books as being the owner of the bond.

A coupon bond is usually transferable by mere delivery and the company fulfills its

obligation as to payment when it makes payment of interest to the holder of the interest coupon calling for the installment of interest then due and payable, or to the holder of the coupon bond when it is due and payable. Some corporate mortgages permit the holder of a coupon bond to have it registered as to principal, the interest coupons remaining transferable by mere delivery and payable to the holder, while the principal is payable only to the person whose name is registered on the books of the company in the same manner as the owner of a registered bond.

With such provisions in a corporate mortgage the investor may safeguard the payment of principal, or both principal and interest, to himself by purchasing a registered bond or coupon bond and having it registered as to principal, or he may assume the risk of loss of coupon bonds not registered as to principal for the greater convenience of effecting a transfer of ownership by mere delivery to the transferee without having recourse to the company.

Execution and Authentication of Bonds

Since a corporation must act by agents, the mortgage stipulates the officer or officers who shall execute the bonds on behalf of the corporation and the officer or officers who shall attest to the affixing of the corporate seal.

Signature of Bonds

As the signing of a large issue of bonds involves a great deal of manual labor and their preparation a considerable expense, the mortgage generally provides that in case the officers of the corporation who shall have signed or sealed any of the bonds shall cease to be officers of the corporation before the bonds have been actually authenticated by the trustee, or delivered or sold, they may nevertheless be adopted by the corporation, upon its written request, and may be thereupon issued as though the persons who had signed or sealed such bonds had not ceased to be officers of the corporation.

Form and Authentication of Interest Coupons and Interest Payments

The usual form of interest coupon is a promise to pay to bearer the amount, at the time and place therein stated. It refers to the designated name of the obligation, interest on which it represents, period of time on which and the rate at which interest is computed. It is signed with the corporate name by the fac-simile signature of the treasurer. An interest coupon in such form is negotiable, and when detached from the bond is not subject to the terms and conditions of the indenture. On the other hand, the holder of a mere detached interest coupon is not entitled to the benefit of the lien created by the indenture, but becomes a general creditor of the corporation. This

negotiable form of interest coupon has come into general use at the insistence of the Listing Committee of the New York Stock Exchange in the interest of the investing public.

For the purpose of making the interest coupons the valid obligation of the corporation and at the same time obviating a vast amount of manual labor, a provision is usually inserted that they shall be authenticated by the engraved fac-simile signature of the present treasurer, or of any future treasurer, of the corporation, and that the corporation may adopt the signature of any person who shall have been the treasurer of the corporation notwithstanding the fact that he may have ceased to be the treasurer at the time when the bonds are actually authenticated or delivered or sold.

Frequently it is contemplated that the entire amount of bonds authorized to be secured by the mortgage will not be issued at once, but from time to time under the terms and conditions of the indenture. Accordingly, it is stipulated when interest shall begin to accrue, and the time fixed is usually the interest payment date next preceding the date on which the bonds are issued. To prevent the payment of unearned interest, it is stipulated that the trustee shall detach all interest coupons on coupon bonds then matured before authenticating any coupon bonds.

Trustee's Certificate

To guard against the issuance of forged, or irregularly issued bonds, it has become the almost universal rule to require the trustee to certify each bond. This is called "authentication by the trustee," and, by the terms of the mortgage, is essential to the validity of the bond. The form of certificate on the face of the bond is to the effect that the bond is one of a series referred to in the within mentioned (i. e. on the face of the bond) mortgage and deed of trust. But it has far greater significance than at first thought its language seems to imply.

By endorsing the certificate, the trustee authenticates the genuineness of the corporate seal and signatures of the corporate officers on the face of the bond, and is personally liable for any damage to the holder and owner if the bond is not genuine, and regularly issued under the terms and conditions of the indenture, as discussed later, so as to entitle it to the benefit of the lien created by the mortgage. Improper authentication by the trustee is gross negligence.

Registration and Transfer Agencies

For the convenience of the investor the corporation generally agrees to maintain one or more transfer offices or agencies in cities reasonably accessible to the holders of the securities where they may present their bonds for exchange into bonds of other denomination or registered bonds for exchange into coupon

bonds, or vice versa. It frequently occurs that a company issuing bonds will, instead of maintaining its own office for the exchange of bonds, appoint another company to perform this work.

Exchangeability

If the corporate mortgage makes provision for both registered and coupon bonds, with perhaps the further provision for coupon bonds registerable as to principal, it is usual to further provide, purely for the convenience of the investor, for the exchange of a registered bond to a coupon bond, or vice versa, or for the discharge of a coupon bond registered as to principal and the restoration of its negotiability by delivery only, by having it made payable to bearer on the books of the company.

Similarly, when the bonds are issued in several denominations, the holder may exchange bonds of one denomination for an equivalent face amount of bonds of other denominations.

But when bonds are issued payable in one or more currencies, at a fixed rate of exchange, there may be restrictions as to exchangeability of bonds payable in one currency for those payable in another.

The indenture generally provides that when a coupon bond is surrendered for a registered bond the coupon bond shall have at the time it is surrendered all unmatured interest coupons attached to it and, of course, where a registered

bond is presented for exchange to a coupon bond, all interest coupons then past due are detached and cancelled before the coupon bond is issued in exchange for the registered bond.

Numbering of Coupon Bonds—Endorsement on Registered Bonds

The mortgage generally provides that coupon bonds shall be numbered consecutively from one upwards, and that the registered bonds shall bear an endorsement that they have been issued in lieu of, or in exchange for coupon bonds, stating the number which such coupon bonds bear and whenever any bonds are originally issued as registered bonds, an equivalent face amount of coupon bonds shall be reserved unissued and the numbers of such coupon bonds so reserved shall be endorsed on the registered bonds so that there shall never be issued and outstanding any two bonds bearing the same number. This facilitates the work of the corporation, the trustee, and the registrar, if any, keeping a record of bonds issued and outstanding.

Charge for Exchange and Transfer

It is stipulated that the holder will pay any transfer tax, and in addition a nominal sum to cover the cost of issuing the new bond.

Bonds Mutilated, Destroyed or Lost

The statutes in many of the states provide a remedy whereby the owner of a mutilated, de-

stroyed or lost certificate of stock or a negotiable instrument may obtain the issue of a new one in the place and stead of the one so mutilated, lost or destroyed. It is customary for similar provisions to be included in the corporate mortgage, irrespective of, but following the same general line of such statutes as obtain. These provisions generally require the filing of an affidavit by the owner as well as indemnity satisfactory to the company and to the trustee, in which event the company may in its discretion issue a new obligation of like tenor and effect as the one mutilated, lost or destroyed. It is generally stipulated, however, in the so-called reissued obligation that if the original obligation should turn up in the hands of a person entitled to claim ownership (the bona fide purchaser of a negotiable instrument) then the reissued bond shall be void. If the owner should fail to furnish proof and indemnity satisfactory to the company he would be forced to resort to the remedy afforded by statute, if any, or seek relief in a court of equity.

Engraved and Temporary Bonds

It is not essential to the validity of a bond that it be engraved, or even printed. It is the language and the signature that count.

Stock Exchanges, notably the New York Stock Exchange, however, require that all securities listed on the exchange shall be engraved and that a reputable company have custody of the plates.

This is a precaution against forgery to the prejudice not only of its own members, but also of the investing public whom it serves, as well as making for durability of securities subject to frequent transfer. The matter of engraving depends upon the circumstances surrounding the issue. But if the indenture specifies that the bonds shall be in engraved form, there may be a stipulation permitting the corporation to issue temporary bonds until they can be exchanged for the definitive engraved forms which require time to prepare.

Temporary bonds are printed, without interest coupons, but otherwise are substantially of the form of the definitive bonds, unless a form of temporary bond is also specified in the indenture.

Issue and Appropriation of Bonds

Under this topic there are grouped the provisions respecting the manner in which and the purposes for which the bonds to be secured by the mortgage may be issued. These are purely contract provisions, that is, they are a matter of bargain between the parties. They add nothing to the validity of the mortgage as such. But they must not be of such a character as to vitiate the validity of the mortgage under the laws of the state or states in which the mortgaged property is situated.

The article of the indenture containing these provisions may appropriately have as its first section a provision limiting the aggregate

amount of the bonds which may at any one time be issued and outstanding under, and enjoying the security of, the mortgage.

The next section may contain the agreement of the parties that only a certain specified part of the total aggregate amount of bonds may be issued for certain specific purposes, the object of this provision being to give assurance to the investor (i. e. the bondholder) that his money loaned to the company by the purchase of bonds will not be wasted, but will be devoted in specified amounts to specific purposes which he approves. The task of seeing that the company complies with this covenant is delegated, by the terms of the mortgage, to the trustee, and constitutes one of the normal functions of the present day trustee of a corporate mortgage.

The remaining sections of this article of the indenture therefore deal with the proof which the company must furnish the trustee and upon which the trustee is authorized under the terms of the mortgage to rely and act by authenticating and delivering the bonds.

Accordingly the next section may appropriately set forth that the company shall deliver to the trustee for authentication, and the trustee shall authenticate and deliver the same as thereafter provided in the article and not otherwise. The additional provision is frequently found that the trustee may thus authenticate the bonds even before the indenture has been recorded.

The next section of the article may specify the face value amount of the bonds which the trustee may authenticate and deliver to the company, or to any other party upon its order, for any one of the purposes enumerated. Two duties are thus laid upon the trustee. First, the trustee is bound to see that at no time are there issued and outstanding bonds whose aggregate face amount exceeds the amount authorized in the mortgage. Second, the trustee is bound not to authenticate bonds aggregating a face amount in excess of the amount specified in the mortgage for any particular purpose, as, for example, the purchase of certain real estate, the construction of a building or plant, the purchase of machinery, the payment of outstanding indebtedness, or the acquisition of stock in some other company, or, in the case of a refunding mortgage, for the exchange and cancellation of bonds which have matured, or are about to mature, or which it is deemed expedient to call for redemption before maturity.

The mortgage generally stipulates that authentication by the trustee shall be conclusive evidence, and the only evidence, that the bond so authenticated has been duly issued and that the holder is entitled to the benefit of the lien created by the indenture.

It would be impractical, however, to require the trustee to go afield to ascertain whether the company has fulfilled the conditions entitling it to call upon the trustee to authenti-

cate and deliver bonds to an amount for one or more of the purposes specified in the mortgage. The mortgage therefore specifies the terms and conditions upon which the trustee shall be justified in authenticating and delivering to the company, or to its order, part of the bonds. Furthermore, it is desirable to guard against any attempt on the part of a corporate officer to procure authentication of bonds for wrongful purposes. Accordingly, the corporation is required to furnish to the trustee proof of such a character as will operate to check any such attempt. Concretely, this proof may consist of a written request of the company signed by its president or a vice-president and its secretary, or one of its assistant secretaries, under the corporate seal, and of certificates of the president, or vice-president, treasurer, chief engineer, and counsel of the company, or any of them. Also a certified copy of the resolutions of the board of directors of the company calling for the authentication and delivery of a specific amount of bonds, stating the purpose, or purposes, for which the proceeds of said bonds are required, the amount of bonds required, and the price at which it is proposed to sell, or otherwise dispose of, the bonds. Also a certified copy of the contract, if any, which the company has entered into, the performance of which on the part of the company will require the payment by the company in bonds, or the proceeds thereof, to an amount which the trustee is asked to authenticate and deliver.

In the case of a public utility, the company may also be required to furnish the trustee with the certificate of a public service commission permitting the corporation to issue bonds for the purpose specified.

The final section of this article may stipulate that receipt by the trustee of the documents specified shall be full protection to the trustee in authenticating and delivering any bonds.

Corporate mortgages are not necessarily by any means first mortgages. Many are out-and-out second mortgages, that is, the company has theretofore executed and delivered an indenture creating a lien which is prior to the lien created by the second mortgage. But more numerous are those indentures, frequently called "first and refunding mortgage" or, "first and consolidated mortgage," which, at the time of execution and delivery create a first lien as to part, and a second, or junior lien as to the rest, residue and remainder of the mortgaged property. Provision is made for the issuance of bonds secured by the first and refunding mortgage to take up in one way or another outstanding obligations secured by a prior lien on that portion of the mortgaged property as to which the first and refunding mortgage at the time of its execution and delivery is a second or junior lien, so that in many instances, a first and refunding mortgage will eventually become a first mortgage on the entire mortgaged premises. In the case of a first and refunding, or first and consolidated

mortgage, or in the case of a mortgage securing bonds to be issued in several series having priority of lien as to the mortgaged premises and possibly bearing different rates of interest, elaborate provisions are necessary to define precisely the rights and priorities of the bondholders, which are affected by the rights of the company as to issuing the bonds. Accordingly elaborate provisions are found defining precisely the terms and conditions under which the company may issue bonds.[1]

Particular Covenants of the Company

Much of the discussion in connection with the covenants of an individual mortgagor applies with equal force to the corporate mortgagor.[2] Many, if not all, of the covenants there enumerated[3] may be found in a typical corporate mortgage, amplified, of course, to meet the more complex situation generally presented by the more extensive character and greater value involved. To these may be added several that obviously are appropriate or of special importance only in the case of a corpor-

[1] (A detailed discussion of First and Refunding Mortgage, First and Consolidated Mortgage, and mortgages securing bonds to be issued in several series bearing different rates of interest and having different priorities of liens in respect of the mortgaged premises, has been purposely omitted, as necessarily tending to inject complexity into the desired elementary character of this work. It is thought that the reader will make better progress if attention is limited at first to the elementary principles as herein presented. With these clearly in mind, little difficulty should be experienced in analyzing the most elaborate provisions to be found.)

[2] (See pp. 24–27.) [3] (See pp. 26–27.)

ate mortgagor, as, that the company will maintain its corporate existence until the mortgage indebtedness is paid, that in order to prevent any accumulation after maturity of coupons or other claims for interest it will not extend or assent to the extension of the time for the payment of interest, or be a party to any arrangement for purchasing or refunding claims for interest, unless deferred to the prior payment in full of the principal and interest on all bonds whose time of payment has not been extended; that it will maintain the priority which the mortgage lien is intended to enjoy, and not permit any charge or lien to arise having priority; that it will maintain the transfer and registration agencies contemplated in the mortgage; and, in view of the many uncertainties surrounding corporate tax matters, the covenant to pay taxes is modified so as to permit the company to contest in good faith the validity of any tax. Also, if the issue of bonds is not limited as to aggregate amount, but the right of the company to issue additional bonds is dependent upon its maintaining a fixed ratio of quick assets to current liabilities, the company is required to covenant that it will maintain the specified ratio and furnish the trustee from time to time with a certified audit of its books of account.

To avoid controversy, this covenant is followed by explicit directions as to how the quick assets shall be computed.

When the company pledges stocks or bonds it

may be required to covenant that it will not increase or permit the increase in the capital stock or bonds of any of the subsidiary companies in which it owns a controlling interest, whose obligations are pledged with the trustee under the indenture, unless the proportion deposited with the trustee to the total amount outstanding shall be maintained by making an additional deposit of the new securities with the trustee.

The covenant of further assurance is especially desirable in that it enables the trustee to procure a proper deed or other instrument perfecting the trustee's title to the mortgaged premises, especially when the mortgage provides that after-acquired property shall become subject to the lien of the mortgage. The covenant is so worded that upon the acquisition of such property by the corporation the trustee may call upon the corporation to give a deed to the trustee therefor, subject to the uses and conditions of the mortgage, so that this property will unquestionably become a part of the mortgaged premises.

It is important to keep in mind that the purpose of these covenants is to safeguard the value of the mortgaged premises in the interest of the mortgagee. They impose a personal liability upon the mortgagor. Aside from the covenant to pay interest and principal promptly when due, they may not be valuable, in terms of currency, to the mortgagee, but the presence of these covenants in the mortgage may be highly important in affording a

basis for stipulating that a breach shall constitute an event of default, so as to permit the trustee to exercise promptly remedies to prevent depreciation in the value of the mortgaged property, disastrous to the mortgagee. Personal liability for a breach of the covenant to pay interest and principal promptly when due may be highly important in paving the way for foreclosure proceedings, also the right to enter a deficiency judgment in the case of a mortgage by an industrial corporation, though in the case of a railroad mortgage a deficiency judgment may only be important to the extent of cutting off unsecured creditors.

The particular covenants which are best designed to attain this purpose will depend upon the circumstances surrounding each transaction, when construed in the light of the remedies afforded either by the terms of the mortgage or by the law of the state.

In Case of Default

The remedies open to a mortgagee in case the mortgagor fails to fulfill each and all of his obligations depend upon the laws of the state or states in which the mortgaged premises are situated. Assuming, however, for the purposes of argument that the instant the mortgagor is guilty of a default, the mortgagee has the immediate right to foreclose the mortgage, it becomes obvious that the immediate exercise of this harsh remedy would create a hardship upon the mortgagor without any corresponding

benefit to the mortgagee. Foreclosure proceedings entail expense to all parties from the very start, no matter where the expense may ultimately rest, and a considerable time must elapse before foreclosure proceedings can result in the reimbursement of the mortgagee for any loss or damage he may have sustained by reason of the mortgagor's default. Moreover, it must be kept in mind that the bond is the principal obligation and that the mortgage is merely accessory thereto affording security to which the mortgagee may have recourse if the principal obligation, with interest, if so provided, is not duly paid.

It is therefore apparent that the covenants of the mortgagor, aside from those to pay the principal and interest promptly when due, are designed and intended to maintain the value of the mortgaged premises, so that if it becomes necessary for the mortgagee to have recourse to the security afforded by the mortgage, i.e., the mortgaged premises, the value of the security will not be found to have depreciated to a hopeless extent, rather than to give an immediate right to the mortgagee to exact the harsh remedy of foreclosure the instant the mortgagor is guilty of a breach of one particular covenant not seriously impairing the value of the mortgaged premises. Accordingly, it is common for the parties to agree just what shall constitute such a breach of covenant on the part of the mortgagor as shall entitle the mortgagee to exercise the remedies afforded by law or

equity, and further to stipulate what, if any, period of time, technically called "period of grace," the mortgagor may have after he has been guilty of a default in order to cure it. Provisions in the mortgage affecting these matters may be grouped in an article under this general heading, and as in the case of particular covenants of the mortgagor, these provisions are a matter of bargain between the parties and may even contravene any except mandatory provisions of law of the state or states in which the mortgaged premises are situated. In order to establish the right of the trustee to exercise the remedy of foreclosure for a breach of the covenants, other than that to pay interest and principal, it is often necessary to stipulate that a breach shall constitute an event of default upon the occurrence of which the trustee may declare the entire mortgage indebtedness immediately due and payable. This is called "maturity by declaration," and when availed of, precipitates the maturity of the bonds and interest coupons.

Since the events of default relate to the particular covenants of the mortgagor, it is futile to undertake to enumerate all that are to be found in corporate mortgages. Some idea of the importance which is attached to them may be gained by noting the period of grace afforded the mortgagor, the remedies open if the default continues after the period of grace, the percentage of bondholders requisite to compel the trustee to act, and the conditions upon which the bond-

holders may resort to their various remedies without the aid of the trustee, if the trustee should fail to act.

1. Regularly, of course, the failure to pay interest is made an event of default, but the mortgagor is given a period of grace varying from 30 to 90 days in which to make good.

2. Failure to pay the principal of the bond when due, whether upon maturity, or by declaration, is always considered a default of prime importance, giving immediate right to the trustee to exercise any and all remedies.

3. And, generally failure to fulfill other particular covenants of the mortgagor are commonly events of default, which the mortgagor is allowed a three months' period of grace to cure after notice by the trustee or upon demand of the holders of a substantial amount of bonds.

It is common to provide that the trustee may waive any default at least upon consent of the holders of a substantial amount of the bonds, usually a majority, without prejudicing the right to act upon any subsequent default.

Remedies

The remedies open to the trustee will depend upon the laws of the state in which the mortgaged property is situated. In general they are those already indicated open to the individual mortgagee and by the terms of the mortgage are cumulative.[1]

[1] (See pp. 61–73.)

The distinctive feature in the corporate mortgage is that the conditions under which the trustee may act, or under which he is required to take action are precisely defined. These conditions vary in different mortgages. The trustee is generally permitted to take discretionary action to safeguard and protect the interests of the bondholders, without specific request. Also to waive many of the minor events of default, unless requested to take action by the holders of a substantial amount of bonds, varying from 10 to 25 per cent.

To preclude irreparable loss, if the trustee refuses to act on account of the danger of incurring personal liability, although the requisite percentage of bondholders under the terms of the indenture have made written request, the right is reserved the bondholders to take action on their own behalf. But this right generally requires the holders of a substantial amount of bonds to unite, and may be exercised only after the requisite percentage have made written request to the trustee, furnished adequate indemnity, and the trustee, after being allowed a reasonable time, fails or refuses to act. Stipulations of this character are necessary because at common law, since any individual bondowner holds the direct obligation of the corporation, he has the right, irrespective of the other bondholders, to take action directly on the debt, and he may in equity compel the trustee to exercise the rights given by the mortgage. Obviously it would be unfair to permit one

bondholder to secure an advantage over others who have as good a claim to the mortgaged property, or to permit one bondholder to seize property not covered by the mortgage which might affect the value of the entire enterprise to the prejudice of the other bondholders, and in any event might at least give one creditor a preference over another of equal rank. Since the law is perhaps not thoroughly established in this respect, it is therefore generally stipulated that action by individual bondholders must be in behalf of all.

Possession Until Default—Defeasance

A corporate mortgage expressly sets forth what is implied in an ordinary mortgage between individuals, that the mortgagor shall remain in possession of the mortgaged premises (as possession in most cases is essential to its earning power) as long as the company is not in default, and it is further provided that when and if the company makes all the payments and fulfills all the covenants as provided in the mortgage, the deed of trust shall thereupon become null and void. In other words, there is the usual defeasance clause, and generally the further express stipulation that the trustee shall on demand give the company entire satisfaction and discharge of the indenture upon the public records. Sometimes it is provided that even though the company has not suffered any default, it may, if it deems expedient, and for the best interest of the bondholders, call

upon the trustee to take over and manage the mortgaged premises for any period fixed or indefinite. This is of doubtful legality, but is designed to forestall attempts to interfere with the exercise by the company of its corporate powers.[1]

Guaranty

There may be an article in the indenture under this heading if a guarantor becomes a signatory party. Very likely it will contain the form of guaranty which the guarantor agrees to endorse on the face of the bonds and recite the consideration moving to the guarantor; also a covenant that if payment is not made by the mortgagor company the guarantor will forthwith furnish to the trustee the necessary funds fully and punctually to make any and all payments, and that if default be made by the guarantor company, the trustee shall have the right to take all necessary steps against the guarantor.

If the guarantor company is organized under the laws of a different state it may be stipulated that the guaranty shall be construed under the laws of the state in which the mortgaged premises are situated.

Concerning the Trustee

The duties, liabilities and the degree of discretion which the trustee is permitted to exercise may be prescribed in the trust deed, or, by omission,

[1] (See note 1, p. 77.)

be left to the law of the state. Theoretically, in the latter event there should be no difficulty. The law of the state is open to all, and no person is excused from not knowing it, least of all the Bar. Practically, however, the matter stands in a far different light. There are few, if any, statutes precisely defining the duties and liabilities of a trustee. Some light might be gleaned by recourse to the reported decisions of the courts where a similar question had been presented for judicial determination. But with a slightly different set of circumstances surrounding a particular problem, there would be the possibility of a different decision if the matter should be presented to a judicial tribunal for determination, so that anything short of such a determination would rest to a certain degree upon personal opinion and judgment, without binding effect if the law were afterwards found to be otherwise.

In view of these conditions which have obtained from the earliest times respecting the duties and liabilities of a trustee, there has been a growing tendency on the part of individual trustees, and especially in the last two decades a growing tendency upon the part of trust companies acting as trustee under corporate mortgages, to insist that their duties as trustee be clearly defined, or, if they are permitted to use their discretion, that they shall be held free from liability if they act in good faith relying upon the opinion of counsel, and that personal liability be limited to wilful

misconduct or gross negligence. The fees ordinarily paid to trustees for their services would be entirely inadequate to compensate them for undertaking the trust unless personal liability were strictly limited.

This article concerning the trustee does not, however, include all that relates to the position. By the very nature of the office the trustee is concerned with all the terms and conditions of the mortgage. In most corporate mortgages the duties of the trustee will be found to be specified in one place and another throughout the indenture; so that in some corporate mortgages the article "concerning the trustee" merely limits personal liability as to some of the duties of the trust, and exempts the trustee from personal liability as to other duties, while in other indentures all the duties of the trustee are grouped in detail in this article, at the expense of repetition.

Examination of a corporate mortgage will disclose that some of the provisions to be found under this heading concern the corporation and the bondholder quite as much as the trustee.

Though the reason for this is not quite obvious it will become apparent upon a moment's reflection on the indenture in its entirety. The scope of recent corporate mortgages involving as they do not only a strict mortgage of property, but also the details of the bonds as well as all the terms of the agreement of the parties necessarily requires a lengthy instrument. Generally the terms of the agree-

ment are such that a covenant or provision affecting one of the parties frequently causes a direct or contingent duty to devolve upon one or all of the other parties to the indenture. Those charged with the preparation of a corporate mortgage are thus confronted with a dilemma: in the interest of brevity they may make a straightforward statement of the terms of the agreement, with cross references to other provisions of the indenture and the party or parties directly affected thereby, or, in the interest of clarity, they may segregate so far as possible, the rights and duties of each of the parties, avoiding much need of cross referencing, which is confusing to the reader, but at the expense of greater repetition. Much will therefore depend on the method employed by counsel preparing the indenture as to what provisions are grouped in this article or any other.

Again, the duties and responsibilities of the trustee depend in each instance upon the terms of the bargain as between the corporation and the investor. These at the same time must prove acceptable to the trustee. It is therefore not feasible to attempt to exhaust the possibilities of variation in the structure of the indenture.

The following are some of the provisions commonly found: the trustee is answerable only for willful misconduct or gross negligence; is not obliged to enforce the terms of the trust unless indemnified by the bondholders; is not

required to take action on default except upon the written request of the holders of a substantial amount of the bonds (the requisite percentage being specified as to each default); is entitled to compensation for services and to receive reimbursement for any expenses incurred in executing the trust; is protected in acting on any notice provided for in the indenture which it believes to be genuine; that it may advise with counsel and shall be protected in acting on the opinion of counsel as to matters affecting the administration of the trust; that it is not responsible for the validity of the indenture or the bonds or for the recitals (all of which are made by and on behalf of the corporation solely). Furthermore, the trustee makes no representation as to the sufficiency of the security and is not responsible for recording the mortgage (which the company undertakes to do at its own expense); the trustee is not personally responsible for taxes or for insuring the mortgaged premises or for any debts, damages, salaries or other non-performance of contract arising during any period wherein the trustee shall manage the mortgaged property; the trustee shall not be responsible for the application of bonds which it has authenticated in conformity with the terms of the indenture, or to the application of the proceeds thereof; and it may rely on the certificate or the certified copy of any resolution of the board of directors, if properly signed and sealed by the officer of the corporation duly author-

ized; and that the receipt of such certificate or certified copy of any resolution shall be full protection to the trustee for any action which the trustee may take in good faith relying on its validity.

It may also be stipulated that any action taken by the trustee upon the consent, or at the request of the holder of a bond shall be conclusive on the future holder of the bond, and also that the trustee may become the owner of bonds and coupons with the same rights which it would have if it were not trustee of the indenture.

Other matters fully treated in this article are those affecting the resignation or removal of the trustee and the appointment of a successor trustee, generally upon the written request of the holders of a substantial amount of the bonds. Provision is made for the appointment of an ad interim trustee by the corporation to serve until the bondholders make the appointment. It is also stipulated that the successor trustee shall forthwith succeed to the right, title and interest in and to the mortgaged premises, and that the trustee ceasing to act shall on demand turn over to the successor trustee all monies belonging to the trust estate and execute any deeds or other instruments to fully confirm the right, title and interest of the successor trustee in and to the mortgaged property.

The indenture may permit the trustee to merge or consolidate with another corporation of a like nature, in which event it may be

stipulated that any company resulting from any merger or consolidation shall succeed to the duties and privileges of the trust. The character of any successor trustee or any company resulting from merger or consolidation may be specified, as that it shall have its principal place of business in a certain city, be organized under the laws of a particular state, and have a specified capital and surplus. This stipulation is generally modified to permit the appointment of another trustee if one of the required character cannot be found who is willing to accept the trust.

Release of Mortgaged Property

The investor in a corporate mortgage bond relies upon two things—first, that the earning power of the corporation is sufficient to enable it to fulfill its obligation, and second, that on the failure of earnings, the value of the mortgaged property, together with the other assets of the company will prove sufficient to repay his loan with interest.

Since the earnings of the corporation may diminish almost to the vanishing point without the occurrence of any one of the events of default which would permit the investor to have recourse to the mortgaged premises prior to the maturity of the obligation, at first thought it seems inconceivable that the investor should be willing to release any part of the mortgaged premises from the lien of the mortgage. Of course, the investor will permit after-acquired

property to come under the lien of the mortgage, because its value would pro tanto enhance the value of the security afforded by the mortgage. Especially if the indenture provides that bonds may be issued for the acquisition of new property, it is logical, and, indeed, indispensable, that such property should come under the lien of the mortgage. It is entirely possible, however, that any after-acquired property may become important in the conduct of the business. Therefore, the investor usually insists that all after-acquired property shall come under the lien of the mortgage. He is concerned with preserving the value of the mortgaged property as part of a going enterprise against the contingency that he may have to resort to it for the repayment of his loan when he will want its full value in use for an existing business.

Whether the investor shall permit the release of any portion of the mortgaged property, and, if so, upon what terms and conditions, will depend on whether the earning power of the corporation may not be affected advantageously by permitting the corporation to dispose of part of its property. Even though its earning power is not increased, the value of the rest of the property may be enhanced by the disposal of a part that may have become a burden rather than a benefit. The question, then, is one of finance rather than of law. It is a matter of bargain between the parties as to whether any or what parts of the mortgaged premises

may be released from the lien of the mortgage. The terms and conditions are a matter of negotiation between the parties and may differ radically in one mortgage from those in another. The only requirement is that in each case the terms be clearly and definitely stated to avoid future dispute.

Some mortgages provide that part of the mortgaged property may be released upon the deposit by the corporation with the trustee of a sum equivalent to its value to be held by the trustee as a special fund in lieu of the released property. The corporation is frequently given the right to apply this special fund to the purchase of new property to be brought under the lien of the indenture, upon satisfying the trustee that the corporation has obtained or made adequate provision for obtaining good title to the new property, and that it is of a value and character specified in the indenture as a permissible application of the special fund. Other mortgages allow the release of part of the mortgaged premises in exchange for new property of equal value which shall immediately come under the lien of the mortgage. When personalty and other chattels are included in the mortgaged property, the mortgagor is generally permitted to dispose of such of them as may become obsolete or useless through wear and tear without procuring a release from the trustee, or even without notice to the trustee on condition that they be replaced or new appliances procured. Any violation of this

privilege would be a breach of the mortgagor's covenant to maintain the mortgaged property.

Of course, the question of a release of a single part of the mortgaged premises does not occur in the case of the mortgage of a single piece of real estate by an individual mortgagor to an individual mortgagee, as any change of the property to be mortgaged could be met far better and more simply by cancelling the old mortgage and executing a new one.

Redemption of Bonds

Many corporate mortgages include provisions for the redemption of part or all of the bonds before maturity, usually upon payment of a premium on their face value, together with accrued interest. This stipulation is sometimes qualified so that the entire issue must be redeemed, if any at all, or, if a mortgage secures a series of bonds, that all of the bonds of one series shall be redeemed if any at all. Other mortgages provide that part of the bonds may be called for redemption by lot, or purchased in the open market, or tenders asked for.

The redemption may be required in definite amounts at certain periods, or in certain contingencies, for or in lieu of a sinking fund, or it may be simply optional with the corporation as a right reserved for the purpose of providing financial flexibility.

Whatever the redemption provisions may be, it is common to stipulate the precise manner in which this option to redeem shall be exercised.

This may require publication in one or more newspapers of general circulation published in one or more cities, of notice specifying the amount of bonds to be redeemed, the place where and time when payable, which is usually the office of the company, on the next interest payment date.

As a corollary to the privilege to redeem, the mortgage stipulates that if the corporation is ready, willing and able to redeem, interest on "called" bonds shall cease after the date of redemption specified in the notice, and all coupons for interest subsequent to that date shall become void.

If it is desired to keep called bonds "alive," the proper procedure is to provide the trustee with the funds to effect the call, and have the trustee hold the bonds as outstanding obligations of the corporation. Since the corporation cannot owe itself, a redemption of the bonds directly by the corporation would effect a cancellation of the debt. It may be desirable to keep the bonds alive, even if the stipulations, as for a sinking fund, prevent a resale. If the bonds are kept alive they can be presented in the event of a foreclosure as a claim and enlarge the deficiency judgment in jurisdictions in which it is allowed and in situations in which it would be of value.

Miscellaneous Provisions

Under this article are grouped provisions that cannot appropriately be placed under any

other heading of the indenture. Just what miscellaneous provisions are necessary or expedient will vary in every mortgage. Some usual miscellaneous provisions follow.

Any request in writing upon the part of holders of bonds may be made in any number of concurrent instruments of similar tenor, signed or executed by the holder or his agent or attorney. The fact and date of execution of an instrument by any person may be proved by the certificate of any notary public, or other officer authorized to take acknowledgments of deeds, or by the affidavit of a witness. Ownership of bonds may be proved by the affidavit or certificate of any trust company, bank or other depositary.

Ownership of registered bonds, or coupon bonds registered as to principal, shall be proved by the registration of such bonds. The corporation and the trustee may treat the person registered on the books of the corporation as the absolute owner of a registered bond for all purposes, and the holder of any interest coupon as the absolute owner.

Since it is expressly agreed that the mortgage and the obligations secured by the indenture are all solely corporate obligations, personal liability against any incorporator, officer, or director, or stockholder of the company is expressly waived. Nothing in the indenture shall prevent the merger or consolidation of the corporation with any other corporation of like character, provided the

consolidation or merger shall not affect the security of the lien, or generally any of the rights or powers of the trustee or the bondholders. The corporation resulting from the merger shall assume the due and punctual payment of interest and principal of all the obligations secured by the lien of the mortgage.

Other provisions relate to definitions, as for example: the term "corporation" shall mean not only the party of the first part to the indenture, but also any successor corporation which shall enjoy and possess every right and power of the original corporation; the word "trustee" shall include any successor trustee or trustees; and the word "bond" or "bondholder" shall include the plural as well as the singular.

Other stipulations may be made as to the manner and method in which the bondholder shall mail notices so as to be binding on the corporation.

Mortgages, especially of railroad property, may contain a stipulation that a certain percentage of the bondholders may consent to reorganization of the company, or may license the trustee to consent to the creation of a prior lien upon the mortgaged premises to avoid foreclosure and sale.

There may be a provision giving the bondholder the right upon certain terms and conditions to convert his bond into preferred or other stock of the company. Such a provision should be indicated in the "whereas" clause,

on the face of the bond, and appear again as a particular covenant of the company agreeing to make the conversion. Such a privilege must comply with the law of the state in which the company is incorporated, especially with respect to the ratio of exchange.

Acceptance by the Trustee

The terms and conditions of the indenture having been set forth it remains for the trustee to accept the trust which is generally made the subject of an express stipulation, and may be followed by a further provision that the indenture may be simultaneously executed in several counterparts, each of which shall be deemed to be an original, constituting one and the same instrument.

Witness Clause

The clause of acceptance by the trustee is followed by the usual witness clause providing for the execution of the instrument by such officers of the corporation and by the trustee, or by the officers of the trust company, if the trustee be a corporation, as have been authorized by the resolution of the board of directors, and ratified, or approved, by the vote of the stockholders, as recited in the preamble.

Signature, Seal and Attestation

Since a corporation is a legal entity and can act only by its officers or agents the signature

must be affixed by one of its officers or agents. The authority to execute the indenture is derived by the directors from the stockholders, and is delegated by the board of directors to one or more certain executive officers. It is therefore necessary that the indenture be signed on behalf of the corporation by an officer having due authority, as recited in the preamble. Of course, the same situation exists with a corporate trustee.

To evidence the corporate signature it remains for the properly authorized officer to affix the corporate seal and to attest the act by signing his name and indicating the office which he holds in the corporation. Individual trustees sign their names and affix their seals. This makes the indenture the act of the parties who are signatory thereto. The holders as already indicated,[1] become parties to the agreement by the purchase of the obligations secured by it.

As already stated,[2] some statutes require the attestation of two or more witnesses.

Acknowledgment

The corporate acknowledgment is accomplished in the same manner as in the case of the individual mortgagor, except that the statutes require the party who makes the affidavit to declare the office which he holds in the corporation, that he is the person holding such office, that he has been duly authorized by the board of directors to execute the inden-

[1] (See pp. 81–82.) [2] (See p. 32.)

ture, and that he has executed the indenture by and on behalf of the corporation pursuant to the order of the board of directors. Generally the statutes further require that the officer who affixes the corporate seal shall make affidavit of the office which he holds in the corporation, that he was duly authorized to affix the seal of the corporation to the indenture, that he knew the seal of the corporation, and that the seal so affixed to the indenture was the seal of the corporation.

Delivery

It then remains for the corporation to make delivery of the document to the trustee. This is accomplished by manual delivery by the duly authorized officer of the corporation to an officer of the corporate trustee duly authorized to accept the indenture.

Recording and Registering

The remarks as to recording and registering a mortgage upon a single piece of real estate by an individual mortgagor to an individual mortgagee[1] apply with equal force to a corporate mortgage, except that the corporate mortgagor generally covenants that it will cause the mortgage to be recorded, and also registered, if required by law, with all convenient speed at its own expense.

Although the corporation has covenanted that it will promptly cause the mortgage to be

[1] (See pp. 33–36.)

duly recorded, and the trustee would under ordinary circumstances be charged with the duty of requiring the corporation to fulfill its covenants, yet the trustee is expressly exempted in most corporate mortgages from any responsibility for recording the instrument. As a practical consideration, then, it remains for the bondholder to assure himself that his lien is properly perfected by due recording and if personal property is included among the mortgaged assets, requiring the mortgage instrument to be recorded as a chattel mortgage, it may be necessary to exercise this vigilance from time to time, as the statutes generally require that a chattel mortgage be re-recorded at fixed periods. This assurance is generally afforded him by the investment banker who distributes the bonds secured by the mortgage.

If the indenture be a composite mortgage upon realty, chattel mortgage, pledge and instrument of assignment, it may be necessary to record it in as many different forms, as in most states chattel mortgages, and similarly instruments of assignment, are required to be recorded in other and different books from those in which mortgages of realty are recorded.

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